

U.C. SANTA CRUZ FOUNDATION

Financial Statements

Years ended June 30, 2018 and 2017

(With Report of Independent Auditors Thereon)

U.C. SANTA CRUZ FOUNDATION

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Report of Independent Auditors

To the Board of Trustees of the
U.C. Santa Cruz Foundation:

We have audited the accompanying financial statements of the U.C. Santa Cruz 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 U.C. Santa Cruz Foundation as of June 30, 2018 and 2017, respectively, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.



Other Matters

Required Supplementary Information

The accompanying management's discussion and analysis on pages 3-7 are required by accounting principles generally accepted in the United States of America to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

PricewaterhouseCoopers LLP

San Francisco, California
October 10, 2018

U.C. SANTA CRUZ FOUNDATION

Management's Discussion and Analysis (Unaudited)

Years ended June 30, 2018 and 2017

U.C. Santa Cruz Foundation (the Foundation) has been dedicated to supporting the core endeavors of University of California, Santa Cruz (UCSC) – teaching, research, and public service since 1974. The Foundation encourages financial support for 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 (MD&A) presents an overview of the financial performance of the Foundation for the fiscal years ended June 30, 2018 and 2017. The MD&A 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 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 2018 and 2017, the Foundation improved its financial condition as indicated by an increase in net position by \$8 million and \$13 million, respectively.

The Statement of Net Position includes all assets, liabilities and deferred inflows. The Statement 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. 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 and gifts to permanent endowments are reflected in change in net position. Unlike for-profit enterprises, a loss in the Statements 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 Statements of Cash Flows. The primary purpose is to provide relevant information about the cash receipts and cash payments of the Foundation. The Statements of Cash Flows help readers assess the Foundation's ability to generate future net cash flows and its ability to meet its obligations as they come due.

U.C. SANTA CRUZ FOUNDATION

Management's Discussion and Analysis (Unaudited)

Years ended June 30, 2018 and 2017

Condensed Financial Information

| | June 30 | | |
|--|-----------------------|-----------------------|----------------------|
| | <u>2018</u> | <u>2017</u> | <u>2016</u> |
| Assets: | | | |
| Cash and cash equivalents | \$ 905,584 | \$ 1,446,841 | \$ 3,088,934 |
| Pledges receivable, net | 3,081,036 | 2,595,104 | 4,308,511 |
| Investments | <u>106,270,563</u> | <u>98,411,840</u> | <u>81,980,889</u> |
| Total assets | <u>\$ 110,257,183</u> | <u>\$ 102,453,785</u> | <u>\$ 89,378,334</u> |
| Liabilities: | | | |
| Current liabilities | 937,445 | 1,238,272 | 912,104 |
| Noncurrent liabilities | <u>825,332</u> | <u>827,152</u> | <u>1,011,623</u> |
| Total liabilities | <u>\$ 1,762,777</u> | <u>\$ 2,065,424</u> | <u>\$ 1,923,727</u> |
| Deferred Inflows from Irrevocable Split interest Agreements | \$ 1,082,985 | 1,065,134 | 1,059,199 |
| Net position: | | | |
| Restricted | | | |
| Nonexpendable | 46,283,857 | 43,823,897 | 39,833,150 |
| Expendable | 60,422,508 | 54,296,187 | 45,502,363 |
| Unrestricted | <u>705,056</u> | <u>1,203,143</u> | <u>1,059,896</u> |
| Total net position | <u>\$ 107,411,421</u> | <u>\$ 99,323,227</u> | <u>\$ 86,395,409</u> |
| Revenues and expenses: | | | |
| Operating revenues | \$ 16,265,620 | \$ 9,508,012 | \$ 10,053,759 |
| Operating expenses: | <u>19,328,566</u> | <u>13,205,006</u> | <u>12,239,718</u> |
| Net operating loss | <u>(3,062,946)</u> | <u>(3,696,994)</u> | <u>(2,185,959)</u> |
| Nonoperating income | 8,691,180 | 12,055,088 | 827,817 |
| Additions to permanent endowments | <u>2,459,960</u> | <u>4,569,724</u> | <u>4,281,878</u> |
| Change in net position | 8,088,194 | 12,927,818 | 2,923,736 |
| Net position: | | | |
| Beginning of year, as previously reported | | | 84,659,208 |
| Cummulative effect of accounting change | | | <u>(1,187,535)</u> |
| Beginning of year, as restated | <u>99,323,227</u> | <u>86,395,409</u> | <u>83,471,673</u> |
| End of year | <u>\$ 107,411,421</u> | <u>\$ 99,323,227</u> | <u>\$ 86,395,409</u> |

U.C. SANTA CRUZ FOUNDATION

Management's Discussion and Analysis (Unaudited)

Years ended June 30, 2018 and 2017

Financial Highlights

In 2018, the Foundation's total assets increased \$7.8 million to \$110.3 million at June 30, 2018, from \$102.5 million at June 30, 2017. In 2017, the Foundation's total assets increased \$13.1 million, from \$89.3 million at June 30, 2016. For 2018 and 2017, the increase is primarily due to appreciation in the fair market value of investments, and gifts for endowments and funds functioning as endowments.

The Foundation's endowment investments comprise of shares of the UC General Endowment Pool (GEP). The share price of the GEP increased from \$35.16 at June 30, 2017 to \$38.08 at June 30, 2018. The share price of the GEP increased from \$30.88 at June 30, 2016 to \$35.16 at June 30, 2017.

Gifts to the Foundation increased by \$4.6 million to \$18.6 million for 2018 from \$14.0 million for 2017. In 2018, gifts to the Foundation classified as operating revenues were \$16.2 million and additions to permanent endowments was \$2.4 million. Gifts to the Foundation increased by \$600 thousand to \$14.0 million for 2017 from \$13.4 million for 2016. In 2017, gifts to the Foundation classified as operating revenues were \$9.4 million and additions to permanent endowments was \$4.6 million for a total of \$14.0 million.

The Board of Trustees approved endowment payouts for fiscal year 2018 of \$4.6 million and \$3.1 million for fiscal year 2017, representing net payout rates of 4.2% of 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 net 4.2% payout rate represents a 4.75% payout less 0.55% of the three-year moving average, \$466 thousand in 2018 and \$428 thousand in 2017 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 \$7.8 million to \$110.3 million at June 30, 2018, from \$102.5 million at June 30, 2017. 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), beneficial interests in irrevocable split-interest agreements administered by third parties, and net pledges receivable. The 2018 increase includes \$7.9 million increase in investments that includes net unrealized investment gains of \$5.6 million and additions to true endowment and funds functioning as endowments of \$4.2 million, payouts of \$5.0 million, realized gains of \$2.3 million and investment income of \$796 thousand, and a \$486 thousand increase in net pledges receivable offset by a decrease \$541 thousand decrease in cash and cash equivalents.

The increase in total assets during fiscal year 2017 from the prior year was \$13.1 million. The 2017 increase includes net unrealized investment gains of \$9.8 million and additions to true endowment and funds functioning as endowments of \$6.2 million offset by \$1.7 million decrease in net pledges receivable and a decrease \$1.6 million decrease in cash and cash equivalents.

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Management's Discussion and Analysis (Unaudited)

Years ended June 30, 2018 and 2017

Total Liabilities

The Foundation's liabilities at June 30, 2018 decreased \$303 thousand, to \$1.8 million from \$2.1 million at June 30, 2017. The decrease was primarily due to a decrease of \$303 thousand of gifts in process, which were distributed to UCSC in the following month. The Foundation's liabilities at June 30, 2017 increased \$142 thousand, to \$2.1 million from \$1.9 million at June 30, 2016. The increase was primarily due to an increase of \$343 thousand of gifts in process, which were distributed to UCSC in the following month offset by the \$192 thousand decrease from a payment to long term debt.

Operating and Nonoperating Revenues and Expenses

The Statements of Revenues, Expenses, and Changes in Net Position present operating and nonoperating revenues and expenses. In 2018, there was an increase in contributions revenues of \$6.8 million. In 2017, there was an increase in contributions revenues of \$546 thousand. The Foundation's disbursements to UCSC increased by \$6.1 million, from \$13.2 million in 2017 to \$19.3 million in 2018, primarily due to greater amount of current gifts transferred to campus of \$4.6 million and increase in payout of \$1.5 million in 2018, compared to \$12.2 million in the previous year.

Nonoperating income (revenues and expenses) includes net investment income, changes in the fair value of investments, and other nonoperating activities. Net nonoperating income decreased \$3.4 million to \$8.7 million 2018 from \$12.1 million in 2017, is primarily due to a decrease unrealized investment gains of \$4.2 million from of \$9.8 million in 2017 to \$5.6 million in 2018, offset by an increase in investment income of \$791 thousand in 2018. Additions to permanent endowments were \$2.5 million in 2018. The comparable amount received in 2017 was \$4.6 million.

Net Position

In 2018 net position increased \$8.1 million compared to an increase of \$12.9 million for 2017, a decrease of \$4.8 million. The 2018 decrease was primarily due to a reduction of change in fair value of investments of \$3.4 million, an increase of \$6.1 million in disbursements to UCSC, offset by an increase in current gifts and additions to permanent endowments of \$4.6 million. In 2017 net position increased \$12.9 million compared to an increase of \$2.9 million for 2016. The 2017 increase was primarily due to the increases in fair value of investments.

Investments

Total investments include shares of the GEP, funds held by State Street Global Advisors (SSGA), and other investment assets that represent third party irrevocable split interest agreements where the Foundation is a beneficiary, which totaled \$106.3 million at June 30, 2018 and \$98.4 million at June 30, 2017. This represents an increase in 2018 of \$7.9 million over the prior year, and an increase in 2017 of \$16.4 million over the prior year.

A substantial portion of the Foundation assets are invested in the GEP. GEP, 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 \$104.5 million in 2018 and \$96.6 million in 2017. The GEP increased \$7.9 million in 2018, and \$16.4 million in 2017 from the prior year. An Investment Policy Statement revised annually by the UC Regents and adopted by the

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Management's Discussion and Analysis (Unaudited)

Years ended June 30, 2018 and 2017

Foundation's Board of Trustees, sets policy long-term risk and performance targets and investment asset allocations for the GEP.

Life income (charitable remainder trust, or CRT) assets are invested by SSGA in fixed income, equities, real estate, commodities, and cash, totaling \$1.3 million as of June 30, 2018 and 2017.

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 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 \$631 thousand and \$1.2 million, as of June 30, 2018 and 2017, respectively.

Endowment Payout

The Foundation's payout policy is 4.75% of a three-year moving average market value of the endowment principal. The endowment expenditure formula is reviewed annually. The Foundation Board of Trustees approved payout rates of 4.75%, respectively, for fiscal years 2018 and 2017. The rates produced payout dollar amounts of \$5.1 million and \$3.5 million in 2018 and 2017, respectively. 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>2018</u> | | <u>2017</u> | | <u>2016</u> |
|--|----------------------|----|-------------------|----|-------------------|
| Gifts for current use and capital projects | \$ 14,270,043 | \$ | 9,641,220 | \$ | 8,503,857 |
| Endowment payouts and withdrawals | 5,013,483 | | 3,517,903 | | 3,692,087 |
| Other | 37,171 | | 36,380 | | 33,458 |
| Total disbursements to UCSC | <u>\$ 19,320,697</u> | \$ | <u>13,195,503</u> | \$ | <u>12,229,402</u> |

New Accounting Pronouncement

During the year the Foundation adopted the GASB statement No. 81 *Irrevocable Split-Interest Agreements* resulting in a restatement of prior periods presented for comparative purposes. Refer to note 2 in the Notes to Financial Statements for further commentary.

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Statements of Net Position

June 30, 2018 and 2017

| Assets | 2018 | 2017 |
|--|----------------|----------------|
| Current assets: | | |
| Cash and cash equivalents | \$ 905,584 | \$ 1,446,841 |
| Pledges receivable, net – current | 1,298,409 | 980,167 |
| Current assets | 2,203,993 | 2,427,008 |
| Noncurrent assets: | | |
| Investments – General Endowment Pool | 104,477,933 | 96,638,962 |
| Investments – other | 1,792,630 | 1,772,878 |
| Pledges receivable, net – noncurrent | 1,782,627 | 1,614,937 |
| Noncurrent assets | 108,053,190 | 100,026,777 |
| Total assets | \$ 110,257,183 | \$ 102,453,785 |
| Liabilities | | |
| Current liabilities: | | |
| Accounts payable and other accrued liabilities | \$ 805,512 | \$ 1,110,060 |
| Trust liabilities | 131,933 | 128,212 |
| Current liabilities | 937,445 | 1,238,272 |
| Noncurrent liabilities: | | |
| Long-term debt | 247,620 | 247,620 |
| Trust liabilities | 577,712 | 579,532 |
| Noncurrent liabilities | 825,332 | 827,152 |
| Total liabilities | \$ 1,762,777 | \$ 2,065,424 |
| Deferred Inflows from Irrevocable Split Interest Agreements | \$ 1,082,985 | \$ 1,065,134 |
| Net Position | | |
| Restricted: | | |
| Nonexpendable: | | |
| Endowments | \$ 46,283,857 | \$ 43,823,897 |
| Expendable: | | |
| Endowments | 32,815,583 | 29,145,874 |
| Funds functioning as endowments | 24,786,612 | 22,953,790 |
| Gifts | 2,820,313 | 2,196,523 |
| Total expendable | 60,422,508 | 54,296,187 |
| Total restricted | 106,706,365 | 98,120,084 |
| Unrestricted | 705,056 | 1,203,143 |
| Total net position | \$ 107,411,421 | \$ 99,323,227 |

See accompanying notes to financial statements.

U.C. SANTA CRUZ FOUNDATION

Statement of Revenues, Expenses and Net Position

Years ended June 30, 2018 and 2017

| | <u>2018</u> | <u>2017</u> |
|---|-----------------------|----------------------|
| Operating revenues: | | |
| Contributions revenue | \$ 16,265,620 | \$ 9,508,012 |
| Total operating revenues | <u>16,265,620</u> | <u>9,508,012</u> |
| Operating expenses: | | |
| Disbursements to University of California, Santa Cruz | 19,320,697 | 13,195,503 |
| Management and general expenses | <u>7,869</u> | <u>9,503</u> |
| Total operating expenses | <u>19,328,566</u> | <u>13,205,006</u> |
| Net operating loss | <u>(3,062,946)</u> | <u>(3,696,994)</u> |
| Nonoperating revenues (expenses): | | |
| Investment income, net | 831,064 | 788,885 |
| Change in fair value of investments | 7,865,408 | 11,304,413 |
| Other nonoperating income (expenses) | <u>(5,292)</u> | <u>(38,210)</u> |
| Total nonoperating revenues, net | <u>8,691,180</u> | <u>12,055,088</u> |
| Income (loss) before other changes | | |
| in net position | 5,628,234 | 8,358,094 |
| Other changes in net position: | | |
| Additions to permanent endowments | <u>2,459,960</u> | <u>4,569,724</u> |
| Change in net position | <u>8,088,194</u> | <u>12,927,818</u> |
| Net position: | | |
| Beginning of year, as previously reported | | 86,980,012 |
| Cummulative effect of accounting change | | <u>(584,603)</u> |
| Beginning of year, as restated | <u>99,323,227</u> | <u>86,395,409</u> |
| End of year | \$ <u>107,411,421</u> | \$ <u>99,323,227</u> |

See accompanying notes to financial statements.

U.C. SANTA CRUZ FOUNDATION

Statements of Cash Flows

Years ended June 30, 2018 and 2017

| | <u>2018</u> | <u>2017</u> |
|---|------------------------|-----------------------|
| Cash flows from operating activities: | | |
| Receipts from contributions | \$ 9,268,839 | \$ 8,296,451 |
| Payments to the University of California Santa Cruz | (19,625,245) | (12,852,665) |
| Payments for administrative or operating expenses | <u>(7,869)</u> | <u>(9,503)</u> |
| Net cash used in operating activities | <u>(10,364,275)</u> | <u>(4,565,717)</u> |
| Cash flows provided by noncapital financing activities: | | |
| Private gifts for permanent endowments | <u>1,539,275</u> | <u>1,884,275</u> |
| Cash flows from investing activities: | | |
| Proceeds from sale and maturities of investments | 12,479,592 | 9,249,077 |
| Investment income, net | 831,064 | 788,885 |
| Purchases of investments | <u>(5,026,913)</u> | <u>(8,806,233)</u> |
| Net cash provided by investing activities | <u>8,283,743</u> | <u>1,231,729</u> |
| Cash flows from capital and related financing activities: | | |
| Principal and interest paid on debt | <u>-</u> | <u>(192,380)</u> |
| Net cash used by financing activities | <u>-</u> | <u>(192,380)</u> |
| Net increase (decrease) in cash and cash equivalents | (541,257) | (1,642,093) |
| Cash and cash equivalents – beginning of year | <u>1,446,841</u> | <u>3,088,934</u> |
| Cash and cash equivalents – end of year | \$ <u>905,584</u> | \$ <u>1,446,841</u> |
| Reconciliation of net operating loss to net cash used in operating activities: | | |
| Net operating loss | \$ (3,062,946) | \$ (3,696,994) |
| Adjustments to reconcile net operating loss to net cash used in operating activities: | | |
| Contributions of securities | (6,510,849) | (2,924,968) |
| Change in operating assets and liabilities: | | |
| Pledges receivable | (485,932) | 1,713,407 |
| Accounts payable and other accrued liabilities | <u>(304,548)</u> | <u>342,838</u> |
| Net cash used in operating activities | \$ <u>(10,364,275)</u> | \$ <u>(4,565,717)</u> |
| Supplemental noncash activities: | | |
| Contributions of securities – operating | \$ 6,510,849 | \$ 2,924,968 |
| Contribution of securities – endowment | 935,897 | 2,685,449 |

See accompanying notes to financial statements.

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Notes to Financial Statements

Years ended June 30, 2018 and 2017

(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 or the University) 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 a Board of Trustees, the membership of which includes the Chancellor of UCSC. 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) New Accounting Pronouncements

In March 2016 the GASB issued statement No. 81 *Irrevocable Split-Interest Agreements*, 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

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Notes to Financial Statements

Years ended June 30, 2018 and 2017

and at least one other beneficiary. Examples of these types of agreements include charitable lead trusts, charitable remainder trusts, and life-interests in real estate. This statement requires that the Foundation recognize assets, liabilities and deferred inflows of resources from irrevocable split-interest agreements administered by the Foundation 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.

The effects of reporting Statement No. 81 in the Foundation's financial statements 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 | | | |
| Current assets | \$ 2,427,008 | \$ - | \$ 2,427,008 |
| Other noncurrent assets | 99,538,020 | 488,757 | 100,026,777 |
| Total assets | \$ 101,965,028 | \$ 488,757 | \$ 102,453,785 |
| Liabilities | \$ 2,065,424 | \$ - | \$ 2,065,424 |
| Deferred Inflows from Irrevocable Split Interest Agreements | \$ - | \$ 1,065,134 | \$ 1,065,134 |
| Net position | | | |
| Restricted nonexpendable | \$ 44,070,621 | \$ (246,724) | \$ 43,823,897 |
| Restricted expendable | 54,625,840 | (329,653) | 54,296,187 |
| Unrestricted | 1,203,143 | - | 1,203,143 |
| | \$ 99,899,604 | \$ (576,377) | \$ 99,323,227 |
| Statement of Revenue, Expense and Changes in Net Position | | | |
| Operating revenue | \$ 9,437,619 | \$ 70,393 | \$ 9,508,012 |
| Operating expenses | 13,205,006 | - | 13,205,006 |
| Nonoperating revenue | 12,107,255 | (52,167) | 12,055,088 |
| Additions to permanent endowments | 4,579,724 | (10,000) | 4,569,724 |
| Change in net position | \$ 12,919,592 | \$ 8,226 | \$ 12,927,818 |

(c) Cash and Cash Equivalents

Cash and cash equivalents consist of demand deposits and investments in 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.

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Notes to Financial Statements

Years ended June 30, 2018 and 2017

(d) Investments

Investments are reported at fair value. Investments consist principally of investments in the UC Office of the Chief Investment Officer's General Endowment Pool (GEP), the Charitable Remainder Trust (CRT) investments held by State Street Global Advisors (SSGA) and beneficial interests in irrevocable split-interest agreements administered by third parties. Realized gains and losses on the sale of marketable securities are determined using the average cost of the securities sold at GEP. Investment income consists of dividend and interest income and is shown net of investment management fees.

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 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 fiscal year-end.

(e) 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, 2018 and 2017, which are expected to be collected after one year have been discounted at 1.6% for 2018 and 1.2% for 2017 and are reflected in the financial statements at their net present value.

Management has established an allowance for uncollectible contributions, which represents 17% of the pledge balance as of June 30, 2018 and 15% as of June 30, 2017, 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 \$818 thousand at June 30, 2018 and \$1 million at June 30, 2017.

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(f) *Trust Liabilities*

The Foundation has been designated as the trustee for eight charitable remainder trusts (the Trusts, or CRTs) as of June 30, 2018 and June 30, 2017. The Trusts are established by donors to provide income to designated beneficiaries. Upon maturity, any remaining 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 liabilities, is established for the present value of the future estimated payments for life income amounts payable; calculated on the basis of standard gift annuity tables and applicable Internal Revenue Service guidelines. The remaining amount is classified as deferred inflows from irrevocable split interest agreements.

For the years ended June 30, 2018 and 2017, 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%.

(g) *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 Statements of Net Position date are considered to be current. All other assets and liabilities are considered to be noncurrent.

(h) *Deferred Inflows from Irrevocable Split Interest Agreements*

Deferred inflows from irrevocable split interest agreements represent an acquisition of net position that apply to a future period. The Foundation classifies changes in irrevocable split interest agreements as deferred inflows. These amounts will be recognized as revenue at the termination of the split-interest agreements.

(i) *Net Position*

Net position includes the following:

Restricted nonexpendable net position consists of permanent endowments 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.

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 UCSC. They also include funds functioning as endowments, which are restricted net position, which can be expended. Investment

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income and appreciation of endowment investments are classified as restricted expendable net position unless otherwise specified by the donor.

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 is not subject to donor-imposed restrictions.

(j) *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, 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, change in classification of permanent endowed assets and debt relief.

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

(k) *Gift Fees*

In accordance with policies established by the UCSC Chancellor to offset costs incurred in the management, administration, and processing of gifts. Upon receipt, 6% of gifts are remitted to UC Santa Cruz and recorded on the accompanying financial statements as disbursements to campus.

(l) *Disbursements and Expenses*

Disbursements and expenses consist primarily of payments made to the University in support of University programs and departments.

(m) *Accounts Payable and Other Accrued Liabilities*

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, 2018 the current gift amount to be transferred in July 2018 of \$806 thousand was recorded in disbursements to University of California, Santa Cruz in the Statement of Revenues, Expenses, and Changes in Net Position and as accounts payable and other accrued liabilities in the Statements of Net Position. At June 30, 2017 the corresponding amount subsequently transferred in July 2017 was \$1.1 million.

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

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(o) **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.

(3) **Cash and Cash Equivalents**

Cash and cash equivalents at June 30, 2018 and 2017 consist of the following:

| | <u>2018</u> | <u>2017</u> |
|-------------------------------|-------------------|---------------------|
| Checking and savings accounts | \$ 274,613 | \$ 210,590 |
| UC Short-Term Investment Pool | 630,971 | 1,236,251 |
| | <u>\$ 905,584</u> | <u>\$ 1,446,841</u> |

At June 30, 2018 and 2017, the carrying amount of the Foundation's demand deposits was \$274,613 and \$210,590, respectively.

The Foundation manages its cash through a major banking institution. Bank balances are fully insured by the Federal Deposit Insurance Corporation up to the applicable limits. The UC Chief Investment Officer'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 fair value. The Foundation earns income based on its average investment in the pool. 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 bank with national recognition.

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(4) Investments

The composition of the Foundation’s investments including its proportionate share of the GEP as of June 30, 2018 and 2017 is as follows (in thousands of dollars):

| Investment type | 2018 | Percentage | 2017 as restated | Percentage |
|-------------------------------|-------------|-------------------|-----------------------------|-------------------|
| Commingled funds: | | | | |
| Balanced funds | \$ 104,478 | 98.3% | \$ 96,639 | 98.2% |
| U.S. equity funds | 440 | 0.4 | 433 | 0.4 |
| Non-U.S. equity funds | 244 | 0.2 | 252 | 0.2 |
| U.S. bond funds | 486 | 0.5 | 469 | 0.5 |
| Real estate investment trusts | 54 | 0.1 | 51 | 0.1 |
| Short-term investments | 22 | — | 14 | — |
| Commingled funds | 105,724 | | 97,858 | |
| Commodities | 70 | 0.1 | 65 | 0.1 |
| Other investments | 476 | 0.4 | 489 | 0.5 |
| | \$ 106,270 | 100% | \$ 98,412 | 100% |

The 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 exist. The fair value of interests in alternative investments is 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, equities, fixed income and other shares in CRT investments. The CRT investments held by SSGA are maintained to approximate the investment composition of the GEP, except the CRT investments do not include alternative investments and real estate. Other investments include beneficial interests from irrevocable split interest agreements administered by third parties.

The Foundation adopted the provisions contained in the Uniform Prudent Management of 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

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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 2018 and 2017, the Foundation approved an endowment payout of 4.75% of the three-year moving average fair values of the endowment as of December 31, 2018 and 2017, with 0.55% of that used to recover noninvestment-related endowment administration costs. Endowment cost recovery fees remitted to UC Santa Cruz are recorded along with the endowment payout on the accompanying financial statements as disbursements to campus.

(5) Fair Value Measurements

Fair value is defined in the accounting standards as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Assets and liabilities reported at fair value are organized into a hierarchy based on the levels of inputs observable in the marketplace that are used to measure fair value. Inputs are used in applying the various valuation techniques and take into account the assumptions that market participants use to make valuation decisions. Inputs may include price information, credit data, liquidity statistics, and other factors specific to the financial instrument. Observable inputs reflect market data obtained from independent sources. In contrast, unobservable inputs reflect the entity’s assumptions about how market participants would value the financial instrument.

A financial instrument’s level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. The following describes the hierarchy of inputs used to measure fair value and the primary valuation methodologies used for financial instruments measured at fair value on a recurring basis:

Level 1 – Prices based on unadjusted quoted prices in active markets that are accessible for identical assets or liabilities are classified as Level 1. Level 1 investments include equity securities and other exchange traded securities.

Level 2 – Quoted prices in the markets that are not considered to be active, dealer quotations, or alternative pricing sources for similar assets or liabilities for which all significant inputs are observable, either directly or indirectly are classified as Level 2. Level 2 investments include fixed- or variable-income securities and commingled funds that are valued using market information.

Investments and other assets classified as Level 3 have significant unobservable inputs, as they trade infrequently or not at all. The inputs into the determination of fair value of these investments and other assets are based upon the best information in the circumstance and may require significant management judgment. Level 3 financial instruments include private equity investments, real estate and beneficial interests in irrevocable split-interest agreements.

Net Asset Value (NAV) – Investments whose fair value is measured at NAV are excluded from the fair value hierarchy. Investments in non-governmental entities that do not have a readily determinable fair value may be valued at NAV. Investments measured at NAV include commingled GEP funds.

Not Leveled – Cash and cash equivalents are not measured at fair value and, thus, are not subject to the fair value disclosure requirements.

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The following tables summarize the investments and other assets reported at fair value within the fair value hierarchy as of June 30, 2018 (in thousands of dollars):

| | Quoted Prices in Active Markets (Level 1) | Other Observable Inputs (Level 2) | Unobservable Inputs (Level 3) | Net Asset Value (NAV) |
|---|--|--|--|--------------------------------------|
| Commingled funds | \$ 908 | 338 | | 104,478 |
| Other investment-commodities | 70 | | | |
| Total investments | \$ 978 | 338 | - | 104,478 |
| Beneficial interests in irrevocable split-interest agreements included in investments-other | | | \$ 476 | |

The following tables summarize the investments and other assets reported at fair value within the fair value hierarchy as of June 30, 2017 (in thousands of dollars):

| | Quoted Prices in Active Markets (Level 1) | Other Observable Inputs (Level 2) | Unobservable Inputs (Level 3) | Net Asset Value (NAV) |
|---|--|--|--|--------------------------------------|
| Commingled funds | \$ 893 | 326 | | 96,639 |
| Other investment-commodities | 65 | | | |
| Total investments | \$ 958 | 326 | - | 96,639 |
| Beneficial interests in irrevocable split-interest agreements included in investments-other | | | \$ 489 | |

(6) 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 is 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

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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.

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, 2018 and 2017 is as follows (in thousands of dollars):

| | <u>2018</u> | <u>2017</u> |
|------------------------|---------------|---------------|
| Commingled funds: | | |
| U.S. bond funds: | | |
| Not rated | \$ 486 | \$ 469 |
| Non-U.S. bond funds: | | |
| Not rated | <u>22</u> | <u>14</u> |
| Total commingled funds | <u>\$ 508</u> | <u>\$ 483</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 investment 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 considered remote.

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(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 Chief Investment Officer’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 Chief Investment Officer’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, 2018 and 2017 is as follows:

| | <u>2018</u> | <u>2017</u> |
|---|-------------|-------------|
| Fixed income securities: | | |
| Commingled funds – U.S. bond funds | 5.41 | 5.01 |
| Commingled funds – short-term investments | 2.01 | 1.49 |

(e) Foreign Currency Risk

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

At June 30, 2018 and 2017, the U.S. dollar balances of Foundation investments that carry foreign currency risk type are as follows (in thousands of dollars):

| | <u>2018</u> | <u>2017</u> |
|---------------------------------|---------------|---------------|
| Commingled funds: | | |
| Various currency denominations: | | |
| Non-U.S. equity | \$ 244 | \$ 252 |
| Total | \$ <u>244</u> | \$ <u>252</u> |

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(7) Related Parties

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

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 postretirement 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 accordance with relevant University policies. Gift fees and other reimbursements are included in disbursements to UCSC in the accompanying financial statements and totaled \$1.1 million and \$1.0 million for the years ended June 30, 2018 and 2017, respectively.

(8) Pledges Receivable

Promises to give, net of discount to present value and allowance for doubtful pledges, as of June 30, 2018 and 2017 are as follows (in thousands of dollars):

| | <u>2018</u> | <u>2017</u> |
|--|-----------------|-----------------|
| Pledges receivable due in one year or less | \$ 1,753 | \$ 1,207 |
| Less allowance for doubtful pledges | <u>(455)</u> | <u>(227)</u> |
| Pledges receivable, current | <u>1,298</u> | <u>980</u> |
| Pledges due between one and five years | 2,243 | 1,951 |
| Pledges due between six and ten years | 20 | 20 |
| Less: | | |
| Allowance for doubtful pledges | (360) | (269) |
| Unamortized discount | <u>(120)</u> | <u>(87)</u> |
| Pledges receivable, noncurrent | 1,783 | 1,615 |
| Total pledges receivable, net | <u>\$ 3,081</u> | <u>\$ 2,595</u> |

Approximately, \$2.6 million and \$1.7 million of the gross pledges receivable as of June 30, 2018 and 2017, respectively, were due from five individuals, corporations, or foundations. Of the \$2.6 million receivable as of June 30, 2018 and the \$1.7 million receivable as of June 30, 2017, approximately \$800 thousand and \$200 thousand, respectively, were due from members of the Foundation Board of Trustees.

(9) Long-Term Debt

Long term debt consists of amounts borrowed from UCSC and the amount payable to UCSC is \$248 thousand dollars for the years ended June 30, 2018 and 2017, and is due in 2026. The original loan agreement indicated that the loan was to be repaid in full upon maturation of four Foundation held trust assets. On June

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30, 2018, there was one remaining trust with \$294 thousand in assets, \$105 thousand in trust liabilities, and \$189 thousand in deferred inflows. UCSC agreed to receive the future proceeds of the trust asset as final payment.

The loan has been classified as a noncurrent liability since the University has informed the Foundation it will not seek payment before the maturation of the trust asset.

(10) Subsequent Events

In preparing these financial statements, the Foundation has evaluated events and transactions for potential recognition or disclosure through October 10, 2018, the date the financial statements were available to be issued.