Financial Statements

John S. and James L. Knight Foundation
Years Ended Dec. 31, 2009 and 2008
With Report of Independent Certified Public Accountants

Ernst & Young LLP

John S. and James L. Knight Foundation

Financial Statements

Years Ended Dec. 31, 2009 and 2008

Contents

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Report of Independent Certified Public Accountants

The Trustees
John S. and James L. Knight Foundation

We have audited the accompanying Statements of Financial Position of the John S. and James L. Knight Foundation (the foundation) as of Dec. 31, 2009 and 2008, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the foundation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the foundation's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing 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 over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the foundation at Dec. 31, 2009 and 2008, and the changes in its net assets and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States.

Ernst & Young LLP

May 19, 2010

John S. and James L. Knight Foundation

Statements of Financial Position

	Dec. 31 2009	2008
Assets		
Investments:		
Investment assets:		
Cash and cash equivalents	**$ 54,516,152**	$ 41,531,635
Interest, dividends and other investment receivables	**14,285,297**	28,685,047
Fair value of derivative instrument	**10,770,806**	5,089,880
U.S. government and agency obligations	**125,479,037**	77,596,471
Government-sponsored enterprises obligations	**23,491,864**	23,141,613
International bonds and other obligations	**66,196,575**	62,982,081
Corporate bonds and other obligations	**96,687,423**	121,921,164
Equity securities	**558,321,310**	483,129,682
Hedge fund investments	**462,732,533**	401,870,922
Alternative equity investments	**529,521,165**	448,947,802
Real estate investments	**87,285,888**	112,528,394
Total investments	**2,029,288,050**	1,807,424,691
Securities pledged to creditors	**82,815,082**	109,555,506
Program-related investments, net	**1,375,000**	1,666,666
Other assets	**3,799,506**	2,272,741
Beneficial interest in remainder trusts	**72,385,414**	53,860,531
Total assets	**$2,189,663,052**	$1,974,780,135
Liabilities and net assets		
Liabilities:		
Payable under securities loan agreement	**$ 84,856,450**	$ 112,258,243
Redemptions received in advance	**18,000,000**	–
Grants payable	**176,339,562**	146,343,049
Other liabilities	**3,660,301**	3,630,737
Pension and other postretirement benefits liability/(asset)	**(700,769)**	1,766,824
Deferred taxes payable	**320,441**	–
Total liabilities	**282,475,985**	263,998,853
Net assets:		
Temporarily restricted	**72,385,414**	53,860,531
Unrestricted	**1,834,801,653**	1,656,920,751
Total net assets	**1,907,187,067**	1,710,781,282
Total liabilities and net assets	**$2,189,663,052**	$1,974,780,135

See accompanying notes.

John S. and James L. Knight Foundation

Statements of Activities

	Year Ended Dec. 31 2009	2008
Changes in unrestricted net assets:		
Investment activity:		
Interest	**$ 11,984,753**	$ 17,614,322
Dividends	**13,934,183**	17,391,304
Net realized (loss)/gain on sale of investments	**(38,937,592)**	55,653,671
Net change in fair value of investments	**346,070,709**	(673,747,422)
Less: investment expenses	**(7,325,064)**	(9,540,569)
Total investment activity	**325,726,989**	(592,628,694)
Contributions received	**–**	80,000
Total investment activity and other support	**325,726,989**	(592,548,694)
Grants approved and expenses:		
Transformation grants	**11,913,550**	31,703,782
Strategic grants	**3,840,000**	16,800,000
Communities grants	**103,596,090**	52,746,574
Journalism Initiative grants	**15,331,772**	34,005,767
National Fund grants	**5,682,105**	4,056,500
Other grants	**1,329,571**	930,655
Grant forfeitures and other	**(4,639,979)**	(1,426,108)
Change in grant payable discount	**(5,955,337)**	4,374,314
Direct charitable activities	**3,297,735**	2,601,383
General and administrative expenses	**11,799,005**	13,218,964
Federal excise and other taxes, net	**1,637,449**	(2,940,310)
Total grants and expenses	**147,831,961**	156,071,521
Increase/(decrease) in unrestricted net assets from operating activities	**177,895,028**	(748,620,215)
Pension and postretirement changes other than net periodic pension and postretirement costs	**14,126**	3,629,769
Increase/(decrease) in unrestricted net assets	**177,880,902**	(752,249,984)
Changes in temporarily restricted net assets:		
Change in value of beneficial interest in remainder trusts	**18,524,883**	(31,932,669)
Total increase/(decrease) in net assets	**196,405,785**	(784,182,653)
Net assets at beginning of year	**1,710,781,282**	2,494,963,935
Net assets at end of year	**$ 1,907,187,067**	$ 1,710,781,282

See accompanying notes.

John S. and James L. Knight Foundation

Statements of Cash Flows

	Year Ended Dec. 31 2009	2008
Operating activities		
Change in net assets	**$ 196,405,785**	$ (784,182,653)
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Net realized (gain)/loss on sale of investments	**38,937,592**	(55,653,671)
Net change in fair value of investments	**(346,070,709)**	673,747,422
Change in value of beneficial interest in remainder trusts	**(18,524,883)**	31,932,669
Changes in operating assets and liabilities:		
Interest, dividends and other investment receivables	**538,604**	2,244,364
Disbursements for program-related investments	**(833,334)**	–
Valuation allowance – program-related investments	**1,125,000**	–
Grants payable	**29,996,513**	30,298,058
Deferred taxes	**320,441**	(3,809,031)
Pension and postretirement liability	**(2,467,593)**	1,435,314
Other liabilities	**(1,497,200)**	(2,192,544)
Net cash used in operating activities	**(102,069,784)**	(106,180,072)
Investing activities		
Proceeds from sale of investments	**546,006,871**	671,772,169
Purchases of investments	**(430,952,570)**	(550,350,369)
Net cash provided by investing activities	**115,054,301**	121,421,800
Net change in cash and cash equivalents	**12,984,517**	15,241,728
Cash and cash equivalents at beginning of year	**41,531,635**	26,289,907
Cash and cash equivalents at end of year	**$ 54,516,152**	$ 41,531,635
Supplemental data		
Federal and state taxes paid	**$ 2,939,000**	$ 1,923,000

See accompanying notes.

1. The Organization

The John S. and James L. Knight Foundation (the foundation), a nonprofit corporation, promotes excellence in journalism worldwide and invests in the vitality of 26 U.S. communities.

2. Significant Accounting Policies

Cash and Cash Equivalents

Cash and cash equivalents are composed of various operating accounts and highly liquid investments with original maturities of 90 days or less.

Property, Plant and Equipment

The foundation records property, plant and equipment as an expense in the year purchased. Property, plant and equipment purchased for 2009 and 2008 was approximately $127,000 and $165,000, respectively, of which approximately $118,000 and $154,000, respectively, are reflected in "General and administrative expenses" with the remainder being reflected in "investment expense" in the Statements of Activities.

Program-Related Investments (PRIs)

In accordance with Section 4944 of the Internal Revenue Code (the code), the foundation is permitted to make investments that are related to its philanthropic programs. These investments are anticipated to have a return lower than fair value. In the year of the investment, the foundation receives a credit toward its distribution requirement. These investments are treated as grants in the year they are distributed. To the extent the investment is recovered by the foundation, the recovery is recognized as a negative distribution. Recoveries are reflected in "Grant forfeitures and other" in the Statements of Activities. There are no recoveries in either 2009 or 2008.

"Program-related investments" in the Statements of Financial Position represent a below market rate loan with a principal amount of $2,500,000. This is a 13 year loan that began in 2007, bearing interest at 1% per annum. The loan terms provide for interest payments only during the first 10 years and principal amortization in years 11 through 13. The foundation intends to hold this loan to maturity. The foundation has recognized a valuation allowance of $1,125,000 against this loan.

2. Significant Accounting Policies (continued)

Use of Estimates

The presentation of financial statements in conformity with accounting principles generally accepted in the United States (GAAP) requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amounts of investment activity and expenses during the reporting period. Actual results could differ from those estimates.

Deferred Taxes

The foundation follows the policy of providing for federal excise tax on the net appreciation (both realized and unrealized) of investments. The deferred federal excise tax in the accompanying financial statements represents tax provided on the net unrealized appreciation of investments.

Implementation of FASB Accounting Standards Codification

On July 1, 2009 Financial Accounting Standards Board (FASB) issued the *FASB Accounting Standards Codification* as the single source of authoritative non-governmental GAAP. The Codification is effective for interim and annual periods ending after Sept. 15, 2009.

All existing accounting standards were superseded as described in ASC 105 (formely Statement No. 168, *The FASB Accounting Codification and the Hierarchy of Generally Accepted Accounting Principles).* All other accounting literature not included in the Codification is non-authoritative.

The foundation has adopted FASB Codification for the fiscal year ended Dec. 31, 2009.

2. Significant Accounting Policies (continued)

Implementation of ASC 820 (formerly FASB Statement No. 157)

In September of 2006, the FASB issued ASC 820 (formerly – Statement No. 157, *Fair Value Measurements*). ASC 820 establishes a standard framework for measuring fair value, clarifies the definition of "fair value" within that framework, and expands disclosures about the use of fair value measurements. This statement:

- Defines fair value as the "sale or exit price" in an orderly transaction.
- Identifies a Fair Value Hierarchy consisting of 3 levels, or types, of assets:
    1) Level one – refers to quoted prices for identical assets or liabilities in an active market.
    2) Level two – will base fair value estimates on "observable inputs" such as comparative transactions.
    3) Level three – will require the use of "unobservable inputs" such as liquidity and unfunded commitments.
- Emphasizes that fair value should be determined based on the assumptions that market participants would use in pricing the asset or liability.

ASC 820 is effective for fiscal years beginning after Nov. 15, 2007 and was adopted on Jan. 1, 2008 by the foundation.

Implementation of ASC 740 (formerly FIN No. 48)

In June 2006 the FASB issued ASC 740 (formerly – Interpretation No. 48, *Accounting Standards for Uncertainty in Income Taxes: An Interpretation of FASB Statement No. 109*). ASC 740 defines how, for financial reporting purposes, an entity treats a tax position that is subject to uncertainty. It requires that an organization estimate the tax liability attributable to uncertain tax positions and then record it as part of the overall expense (and related liability) for income taxes. The foundation has adopted ASC 740 for the fiscal year ended Dec. 31, 2009.

The foundation's management analyzed its tax positions and determined that no additional income tax adjustment related to the adoption of the ASC 740 is necessary.

2. Significant Accounting Policies (continued)

Implementation of ASC 825 (formerly FASB Statement No. 159)

The foundation adopted FASB ASC 825 (formerly FASB Statement No. 159 *The Fair Value Option for Financial Assets and Financial Liabilities*) for the fiscal year ended Dec. 31, 2009. ASC 825 permits entities to elect to measure many financial instruments and certain other items at fair value. The foundation did not elect the fair value option for any assets or liabilities, which were not previously carried at fair value. Accordingly, the adoption of ASC 825 had no impact on the foundation's financial statements.

Implementation of ASU 2010-9

On February 24, 2010 the FASB issued ASU 2010-9 to amend ASC 855, *Subsequent Events.* The foundation has evaluated subsequent events through May 18, 2010 noting no impact on the foundation's financial statements.

Reclassifications

Certain amounts in the prior year's financial statements have been reclassified to conform to the current year's presentation.

Net Asset Accounting

The foundation reports information regarding its financial position and activities according to the following two classes of net assets:

- Unrestricted net assets are not subject to donor-imposed stipulations or the restrictions have expired.

- Temporarily restricted net assets are subject to donor-imposed stipulations that can be fulfilled by actions of the foundation or that expire by the passage of time.

The foundation has no permanent restriction on its assets imposed by its founders.

3. Investments

The investment goal of the foundation is to invest its assets in a manner that will achieve, over the long term, a total rate of return sufficient to replace the assets utilized for grants and expenses and to recoup any value lost due to inflation and to increase the spending power of the portfolio in a manner consistent with the risk and asset allocation parameters established by the investment committee.

To achieve this goal, some investment risk must be taken. To minimize such risk, the foundation diversifies its investments among various financial instruments and asset categories, and uses multiple investment strategies and investment managers. Key decisions in this regard are made by the foundation's investment committee, which has oversight responsibility for the foundation's investment program. The committee identifies appropriate asset categories for investments, determines the allocation of assets to each category and approves the investment strategies employed. The foundation has engaged Cambridge Associates LLC (Cambridge), an independent consulting firm, to execute the investment program, including the engagement of investment managers, legal advisers, and strategic allocations to index funds and limited partnerships. All financial assets are held in custody for the foundation in proprietary accounts by BNY Mellon, a major commercial bank, except those assets that have been invested in limited partnerships, hedge funds or in certain products with multiple investors, such as index funds, all of which have separate custodial arrangements appropriate to their legal structure.

Approximately 41 percent and 39 percent of the foundation's total investments at Dec. 31, 2009 and 2008, respectively, are invested in institutional mutual funds, publicly traded securities that are listed on national exchanges, treasury and agency bonds of the U.S. government, bonds of sovereign foreign governments and investment and non-investment grade corporate bonds for which active trading markets exist. Such assets are valued at quoted closing prices at year end in accordance with GAAP. Realized gains and losses and increases and decreases in fair value on such investments are reflected in the Statements of Activities.

Approximately 26 percent of the foundation's total investments at Dec. 31, 2009 and 2008 were invested in hedge funds and derivative instruments. The hedge funds utilize a variety of investment strategies which can be broadly categorized as absolute return and long/short equities strategies. The derivative instruments consisted of a "portable alpha" product. These investments are not publicly listed or traded, and are not liquid investments. Investments in hedge funds are generally subject to a "lock up" period of between 12 and 36 months. During that period funds may not be withdrawn from the fund. The redemption terms of hedge funds may vary, but in general terms after the lock up period, redemption request may be made by the foundation on a

3. Investments (continued)

pre-set basis, usually quarterly, as specified in each hedge fund's operating agreement. As of year end 2009 and 2008 no restriction on redemptions were implemented by hedge funds within the foundation's portfolio. Each fund's investment manager calculates the fair value of investments on a monthly basis using the valuation guidelines stipulated in the respective investment agreement, in accordance with fair value methods accepted under GAAP (see discussion of ASC 820 below). Realized gains and losses and increases and decreases in fair value on the investments in hedge funds and derivative instruments are reflected in the Statements of Activities.

On Dec. 31, 2009 the foundation received $18,000,000 for a hedge fund redemption that was settled on Jan. 1, 2010. As the result, a payable of $18,000,000 was reported in "Redemptions received in advance" on the Statements of Financial Position at Dec. 31, 2009.

Approximately 31 and 30 percent of the foundation's total investments at Dec. 31, 2009 and 2008, respectively, were invested with numerous partnerships, in which the foundation is a limited partner, that specialize in making venture capital, buyout, distressed debt, and equity-based real estate investments. Such investments, typically investments in private equity or debt securities of companies or properties that are not publicly listed or traded, are not liquid investments. Investments in private partnerships generally have terms of approximately ten years plus several years of optional extensions. Following the investment period, the general partner sells assets of the partnership over the partnership's remaining term and distributes funds to the partners as mandated in the partnership agreements. The foundation cannot, generally, redeem its interest in a partnership prior to the termination date of the Partnership. The value of such investments is determined by the partnerships' general partners, who must follow the valuation guidelines, such as appraisals and comparable company trade data, stipulated in the respective limited partnership agreements and in accordance with fair value methods accepted under GAAP (see discussion of ASC 820 below). Realized gains and losses and increases and decreases in fair value on the investments in limited partnerships are reflected in the Statements of Activities. All limited partnerships are audited annually by independent certified public accounting firms. As of Dec. 31, 2009, pursuant to its limited partnership agreements, the foundation is committed to contributing approximately $232,227,000 in additional capital over the next 10 years to various partnerships. Unpaid commitments at Dec. 31, 2008, were approximately $320,426,000.

3. Investments (continued)

A detail of fair value and cost by investment class follows:

	Dec. 31, 2009		Dec. 31, 2008	
	Fair Value	**Cost**	**Fair Value**	**Cost**
Cash and cash equivalents	**$ 54,516,152**	**$ 54,516,152**	$ 41,531,635	$ 41,531,635
Interest, dividends and other investment receivables	**14,285,297**	**14,304,212**	28,685,047	28,189,382
Fair value of derivative instrument	**10,770,806**	**–**	5,089,880	–
U.S. government and agency obligations	**125,479,037**	**117,132,201**	77,596,471	45,681,908
Government–sponsored enterprises obligations	**23,491,864**	**9,970,185**	23,141,613	22,394,062
International bonds and other obligations	**66,196,575**	**63,410,669**	62,982,081	62,278,469
Corporate bonds and other obligations	**96,687,423**	**96,867,652**	121,921,164	132,499,288
Equity securities	**558,321,310**	**573,609,774**	483,129,682	719,487,993
Hedge fund investments	**462,732,533**	**266,644,008**	401,870,922	293,225,335
Alternative equity investments	**529,521,165**	**647,167,404**	448,947,802	618,833,272
Real estate investments	**87,285,888**	**115,101,068**	112,528,394	101,816,038
Total	**$ 2,029,288,050**	**$ 1,958,723,325**	$ 1,807,424,691	$ 2,065,937,382

Highly liquid investments with original maturities of three months or less are reported as cash equivalents.

As discussed in Note 2 to these financial statements, the foundation adopted ASC 820, *Fair Value Measurements*, as of January 1, 2008. As required by ASC 820, investments are measured on a fund-by-fund basis and reported at fair value in one of the following categories based on inputs:

> Level 1 – Quoted prices are available in active markets for identical investments as of the reporting date. The types of investments which are included in Level 1 include listed equity securities, commingled funds traded in active markets with daily pricing and cash and cash equivalents. As required by ASC 820, the foundation, does not adjust the quoted price for these investments.
>
> Level 2 – Pricing inputs are observable for the investment, either directly or indirectly, as of reporting date but are not the same as those used in Level 1. Fair value is determined through the use of models or other valuation methodologies. The types of investments included in this category are all other commingled funds, publicly-traded securities with restrictions on disposition and fixed income securities.

3. Investments (continued)

Level 3 – Pricing inputs are unobservable for the investment and include situations where there is little, if any, market activity for the investment. The foundation uses the Net Asset Value determined by the investment manager as fair market value except where certain conditions exist. Those conditions include; changes to key personnel, material amendments to key terms, material pending litigations, imposition of gates, redemption fees, material amendments to key terms and material pending litigations. Investments in hedge funds, alternative equity and real estate investments are included in this category.

The following table summarizes the levels in the ASC 820 fair value hierarchy into which the foundation's investments fall as of Dec. 31, 2009 and 2008:

		Fair Value Measurement at Dec. 31, 2009		
		Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs
Description		**(Level 1)**	**(Level 2)**	**(Level 3)**
Cash and cash equivalents	**$ 54,516,152**	**$ 10,026,670**	**$ 44,489,482**	**$ –**
Interest, dividends and other investment receivables	**14,285,297**	**14,285,297**	**–**	**–**
Fair value of derivative instrument	**10,770,806**	**–**	**–**	**10,770,806**
U.S. government and agency obligations	**125,479,037**	**–**	**125,479,037**	**–**
Government-sponsored enterprises obligations	**23,491,864**	**–**	**23,491,864**	**–**
International bonds and other obligations	**66,196,575**	**–**	**66,196,575**	**–**
Corporate bonds and other obligations	**96,687,423**	**–**	**96,687,423**	**–**
Equity securities	**558,321,310**	**453,429,764**	**104,891,546**	**–**
Hedge fund investments	**462,732,533**	**–**	**–**	**462,732,533**
Alternative equity investments	**529,521,165**	**–**	**–**	**529,521,165**
Real estate investments	**87,285,888**	**–**	**–**	**87,285,888**
Total investments	**$ 2,029,288,050**	**$ 477,741,731**	**$ 461,235,927**	**$ 1,090,310,392**

3. Investments (continued)

		Fair Value Measurement at Dec. 31, 2008		
		Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs
		(Level 1)	(Level 2)	(Level 3)
Description				
Cash and cash equivalents	$ 41,531,635	$ (22,837,628)	$ 64,369,263	$ –
Interest, dividends and other investment receivables	28,685,047	28,685,047	–	–
Fair value of derivative instrument	5,089,880	–	–	5,089,880
U.S. government and agency obligations	77,596,471	–	77,596,471	–
Government-sponsored enterprises obligations	23,141,613	–	23,141,613	–
International bonds and other obligations	62,982,081	–	62,982,081	–
Corporate bonds and other obligations	121,921,164	–	121,921,164	–
Equity securities	483,129,682	419,846,771	63,282,911	–
Hedge fund investments	401,870,922	–	–	401,870,922
Alternative equity investments	448,947,802	–	–	448,947,802
Real estate investments	112,528,394	–	–	112,528,394
Total investments	$ 1,807,424,691	$ 425,694,190	$ 413,293,503	$ 968,436,998

The preceding table includes a negative balance for Level 1 cash and cash equivalents. This negative balance represents the value of checks written but uncashed as of Dec. 31, 2008.

3. Investments (continued)

The changes in investments classified as Level 3 are as follows for the year ended Dec. 31, 2009 and 2008:

Level 3 Reconciliation

	Fair Value Measurements Using Significant Unobservable Inputs				
	Hedge Funds	**Alternative Equity**	**RE Investments**	**Other**	**Total**
Beginning balance Jan. 1, 2009	**$ 401,870,922**	**$ 448,947,802**	**$ 112,528,394**	**$ 5,089,880**	**$ 968,436,998**
Purchases, issuances, and settlements	**(37,907,349)**	**32,529,017**	**13,304,929**	**–**	**7,926,597**
Total gains or (losses) (realized/unrealized)	**98,768,960**	**48,044,346**	**(38,547,435)**	**5,680,926**	**113,946,797**
Ending balance Dec. 31, 2009	**$ 462,732,533**	**$ 529,521,165**	**$ 87,285,888**	**$ 10,770,806**	**$1,090,310,392**
The amount of total gains or losses for the period included in Change in Net Assets attributable to the Change in Unrealized Gains of losses relating to assets still held at the reporting date	**$ 79,484,540**	**$ 37,966,240**	**$ (38,694,953)**	**$ 5,680,926**	**$ 84,436,753**

3. Investments (continued)

	Fair Value Measurements Using Significant Unobservable Inputs				
	Hedge Funds	Alternative Equity	RE Investments	Other	Total
Beginning balance Jan. 1, 2008	$ 537,086,580	$ 479,439,834	$ 117,192,054	$ 9,697,607	$1,143,416,075
Purchases, issuances, and settlements	(7,473,259)	65,013,962	17,387,584	–	74,928,286
Total losses (realized/ unrealized), net	(127,742,399)	(95,505,994)	(22,051,244)	(4,607,727)	(249,907,363)
Ending balance Dec. 31, 2008	$401,870,922	$448,947,802	$112,528,394	$5,089,880	$968,436,998
The amount of total net losses for the period included in change in net assets attributable to the change in unrealized gains of losses relating to assets still held at the reporting date	$ (160,808,047)	$ (115,809,253)	$ (24,332,918)	$ (4,607,727)	$ (305,557,945)

Gains and losses (realized and unrealized) are included in Change in unrestricted net assets” in the Statement of Activity for the year ended Dec. 31, 2009 and 2008.

4. Derivative Financial Instruments

Some investment managers retained by the foundation have been authorized to use certain derivative financial instruments in a manner set forth by the foundation’s written investment policy, specific manager guidelines or partnership/fund agreement documents. Specifically, derivative financial instruments may be used for the following purposes: (1) currency forward contracts and options may be used to hedge non-dollar exposure in foreign investments; (2) covered call options may be sold to enhance yield on major equity positions; (3) futures contracts may be used to equitize excess cash positions, rebalance asset categories within the portfolio, adjust risk exposures within the portfolio, or to rapidly increase or decrease exposure to specific investment positions in anticipation of subsequent cash trades; and (4) futures contracts and options may be used by hedge fund managers to hedge or leverage positions in portfolios in their respective funds. Authorization to use these derivative financial instruments currently is restricted to 29 hedge fund managers, who manage investments totaling approximately $462,732,533.

4. Derivative Financial Instruments (continued)

Cambridge is also authorized to use derivatives to execute certain investment strategies. Derivative financial instruments are recorded at fair value in the Statements of Financial Position with changes in fair value reflected in the Statements of Activities.

During 2009 and 2008 the foundation invested in a “portable alpha” product which is designed to provide a return in excess of a certain benchmark. The investment manager invests the principal in a basket of securities that replicates the benchmark, and then leverages the principal investment and invests in fixed income strategies. The foundation’s equity investment is benchmarked to the Standard & Poor’s 500 Index and is valued at approximately $26,277,808 at Dec. 31, 2009. The foundation’s fixed income investment is benchmarked to the Barclays Capital U.S. 5+ year Treasury Bond Index and is valued at approximately $18,384,056 and $18,658,618 at Dec. 31, 2009 and Dec. 31, 2008, respectively. A receivable of approximately $10,771,000 and $5,090,000 at Dec. 31, 2009 and Dec. 31, 2008, respectively, reflecting the fair value of the leveraged investments was reported in “Receivable related to derivative instrument” on the Statements of Financial Position, and an equal amount was included in “Net change in fair value of investments” in the Statements of Activities.

In Cambridge’s opinion, the use of derivative financial instruments in its investment program is appropriate and customary for the investment strategies employed. The foundation’s management concurs with this opinion. Using those instruments reduces certain investment risks and generally adds value to the portfolio. The instruments themselves, however, do involve some investment and counterparty risk not fully reflected in the foundation’s financial statements. Cambridge does not anticipate that losses, if any, from such instruments would materially affect the financial position of the foundation and the foundation’s management concurs.

5. Grants

The foundation records grants in full as expenses when approved. Grants payable at Dec. 31, 2009 and 2008 represent the present value of multiyear grants using a 3.25 percent discount rate, in each year. The foundation made grant payments of $105,887,097 and $116,206,414 in 2009 and 2008, respectively.

5. Grants (continued)

As of Dec. 31, 2009, the foundation had future grant commitments, which are scheduled for payment in future years as follows:

2010	$ 62,490,430
2011	42,097,688
2012	26,263,409
2013	17,018,810
2014	15,148,810
2015 – 2018	30,559,760
	193,578,907
Discounted to present value	(17,239,345)
Grants payable	$ 176,339,562

6. Federal Excise Taxes

The foundation qualifies as a tax-exempt organization under Section 501(c)(3) of the code and, with the exception of unrelated business income from debt-financed, passive investments, is not subject to federal or state income tax. However, the foundation is classified as a private foundation and is subject to a federal excise tax of 2 percent (or 1 percent under certain circumstances) on net investment income and net realized gains, as defined by the code. The foundation expects to qualify for the 1 percent tax rate in 2009 and was subject to the 1 percent tax rate in 2008.

Total excise and other taxes paid by the foundation for the years ended Dec. 31, 2009 and 2008 amounted to approximately $2,939,000 and $1,923,000, respectively. The foundation recognized $1,086,000 in deferred tax assets during 2009, of which $803,000 was applied against the 2009 estimated tax liability and $283,000 is expected to be received as a tax refund. No valuation allowance is applied against either amount.

7. Employee Pension Plan and Other Postretirement Benefit Plans

The foundation sponsors a pension plan with defined benefit and cash balance features for its eligible employees. The pension benefits for all employees hired prior to Jan. 1, 2000, will be the greater of the benefits as determined under the defined benefit feature of the pension plan or the cash balance feature of the pension plan. The pension benefits for all employees hired on or subsequent to Jan. 1, 2000, will be determined under the cash balance feature of the pension plan. The foundation also sponsors postretirement medical and life insurance benefit plans.

The following table sets forth the pension and other postretirement benefits plans' funded status and amounts recognized in the foundation's Statements of Activities and Financial Position:

	Pension Plan		Other Postretirement Benefit Plan	
	Year Ended Dec. 31		Year Ended Dec. 31	
	2009	**2008**	**2009**	**2008**
Funded status				
Fair value of plan assets	**$ 11,782,417**	$ 8,763,010	**$ 1,120,613**	$ 816,179
Benefit obligation	**(10,308,855)**	(9,673,319)	**(1,893,406)**	(1,672,694)
Funded status of the plan	**$ 1,473,562**	$ (910,309)	**$ (772,793)**	$ (856,515)
Prior service cost	**$ 18,610**	$ 20,963	**$ –**	$ –
Accumulated gain (loss)	**(3,492,344)**	(3,438,879)	**89,740**	48,045
Pension and postretirement changes other than net periodic pension and postretirement costs	**(3,473,734)**	(3,417,916)	**89,740**	48,045
Cumulative employer contribution in excess (deficiency) of net periodic benefit costs	**4,947,296**	2,507,607	**(862,533)**	(904,560)
Accrued benefit asset (liability) recognized in the Statements of Financial Position	**$ 1,473,562**	$ (910,309)	**$ (772,793)**	$ (856,515)

7. Employee Pension Plan and Other Postretirement Benefit Plans (continued)

	Pension Plan		Other Postretirement Benefit Plan	
	Year Ended Dec. 31		Year Ended Dec. 31	
	2009	**2008**	**2009**	**2008**
Components of net periodic benefit cost				
Service cost	**$ 441,199**	$ 447,393	**$ 162,699**	$ 179,711
Interest cost	**562,756**	570,391	**99,456**	87,890
Expected return on plan assets	**(959,595)**	(752,529)	**(90,026)**	(71,534)
Amortization of prior service cost	**(2,356)**	(2,356)	**–**	–
Recognized actuarial loss (gain)	**18,307**	–	**(11,788)**	(24,586)
Net periodic benefit cost	**$ 60,311**	$ 262,899	**$ 160,341**	$ 171,481
Actual return on plan assets	**$ 1,592,760**	$ (2,304,755)	**$ 177,291**	$ (233,636)
Employer contributions	**2,500,000**	2,421,093	**202,371**	207,745
Employee contributions	**–**	–	**23,022**	12,112
Benefits paid	**1,073,353**	842,897	**98,250**	76,725
Actuarial assumptions				
Discount rate	**5.66%**	6.35%	**6.00%**	6.14%
Expected return on plan assets	**8.00**	8.00	**8.00**	8.00
Rate of compensation increase	**4.50**	5.00	**4.50**	5.00
Health care cost trend rate assumptions				
Initial trend rate	**N/A**	N/A	**9.30%**	11.00%
Ultimate trend rate	**N/A**	N/A	**4.50**	5.25
Year ultimate trend is reached	**N/A**	N/A	**2028**	2014

The expected long-term rate of return on plan assets for determining net periodic pension cost is chosen by the foundation from a best estimate range determined by the actuary by applying anticipated long-term returns and long-term volatility for various asset categories to the target asset allocation of the plan.

The calculations related to other postretirement benefit plans do not anticipate any savings from the Medicare Prescription Drug, Improvement and Modernization Act of 2003.

7. Employee Pension Plan and Other Postretirement Benefit Plans (continued)

Expected benefit payments are as follows:

	Pension Plan	Other Postretirement Benefit Plan
2010	$ 632,421	$ 77,032
2011	601,504	85,371
2012	863,056	98,068
2013	765,559	96,730
2014	764,427	101,846
2015 – 2019	4,867,826	655,393

During 2010, the foundation is not required to make any contributions to the pension plan. The foundation will be required to make a contribution of $77,032 to the other post-retirement benefit plan. The foundation may choose to make additional contributions to either plan during 2010.

The investment goal for plan assets is to provide sufficient liquidity to meet payout requirements while maintaining safety of principal through prudent diversification. During 2009 asset allocation targets for the pension plan were large-cap domestic equity, 40 percent, small-cap domestic equity, 10 percent, international equity, 20 percent, domestic fixed income, 20 percent, and Treasury Inflation-Protected Securities, 10 percent. During 2009 asset allocation targets for the other postretirement benefit plan were large-cap domestic equity, 65 percent, small-cap domestic equity, 10 percent, international equity, 10 percent, domestic fixed income, 10 percent, and domestic high yield, 5 percent.

7. Employee Pension Plan and Other Postretirement Benefit Plans (continued)

A detail of the fair value of plan assets by investment class follows:

	Pension Plan				Other Postretirement Benefit Plan			
	Dec. 31				Dec. 31			
	2009	**%**	**2008**	**%**	**2009**	**%**	**2008**	**%**
Cash and cash equivalents	**$ 1,362,047**	**12%**	$ 2,681,818	31%	**$ 95,388**	**8%**	$ 275,688	34%
Interest, dividends and other investment receivables	**19,751**	**–**	23,589	–	**38**	**–**	181	–
U.S. government and agency obligations	**1,919,595**	**16**	1,936,879	22	**–**	**–**	–	–
Corporate bonds and other obligations	**1,330,860**	**11**	410,336	5	**219,882**	**20**	136,501	17
Equity securities	**7,150,164**	**61**	3,710,388	42	**805,305**	**72**	403,809	49
Total	**$ 11,782,417**		$ 8,763,010		**$ 1,120,613**		$ 816,179	

In addition, the foundation sponsors a defined contribution plan for its eligible employees for which it has no fixed liabilities. Effective Jan. 1, 2002, the foundation's defined contribution plan was amended to add an employer matching contribution component. During 2009 and 2008, the foundation made contributions to the defined contribution plan of approximately $182,000 and $180,000, respectively.

The following table summarizes the levels in the ASC 820 fair value hierarchy into which the pension and other postretirement benefit plans assets fall as of December 31, 2009:

	Level 1	Level 2
Pension Plan		
Cash and cash equivalents	$ 1,362,047	$ –
Interest, dividends and other investment receivables	19,751	–
U.S. government and agency obligations	–	1,919,595
Corporate bonds and other obligations	–	1,330,860
Equity securities	7,150,164	–
	$ 8,531,962	$ 3,250,455
Other Postretirement Benefit Plans		
Cash and cash equivalents	$ 95,388	$ –
Interest, dividends and other investment receivables	38	–
Corporate bonds and other obligations	–	219,882
Equity securities	805,305	–
	$ 900,731	$ 219,882

8. Leases

The foundation has a lease for approximately 21,300 square feet of office space in Miami, Fla., which expires in 2013. Rental expense for office and equipment leases for 2009 and 2008 was approximately $833,000 and $803,000, respectively. Future minimum lease payments for the office lease are as follows:

2010	$ 752,957
2011	768,921
2012	784,884
2013	459,401
Total	$ 2,766,163

9. Beneficial Interest in Remainder Trusts

The foundation has a beneficial interest in charitable remainder trusts established by John S. Knight. Under the terms of the trusts, distributions are made from the trusts to designated beneficiaries for the remainder of their lives. The remainder of the assets in the trusts will be transferred to the foundation. All of the assets of the trusts are administered and held in the custody of First Merit bank. The trusts were established in 1975 and became irrevocable in 1981.

The foundation values its interest in the trusts using the methodology described in the National Committee on Planned Giving's 2009 publication, *Valuation Standards for Charitable Planned Gifts*. This methodology is a two-step process starting with the fair market value of the assets. The first step uses a 5 percent payout rate, life expectancy based on IRS Mortality Tables and assumed investment returns to determine the value of the interest at its projected termination. The second step discounts this future value using the Consumer Price Index. As of Dec. 31, 2009 and 2008 the value of the foundation's estimated interest in the remainder trusts was approximately $72,385,000 and $53,861,000, respectively.

For the purposes of ASC 820 application, all beneficial interest in remainder trust assets are classified as Level 2 assets and are composed of $1,592,000, cash & cash equivalents, $19,306,000, government and corporate obligations, and $51,487,000, equity securities.

10. Securities Lending

The Foundation lends certain securities to generate investment income. Selected securities are loaned and securitized primarily by collateral in the form of cash or cash equivalents equal to at least 102% of the fair market value of the securities. As of Dec. 31, 2009, the Foundation recognized “Securities pledged to creditors” for the fair market value of securities on loan of $82,815,000 and a corresponding liability of $84,856,000 was recognized for collateral received. Collateral received by the Foundation, consisted of $66,896,000 in cash and $17,960,000 in short-term government obligations as of Dec. 31, 2009; and $109,067,000 in cash and $3,192,000 in short-term government obligations as of Dec. 31, 2008. Of the cash collateral received, $27,594,000 was invested in securities with maturities of 90 days or less and $39,303,000 was invested in corporate obligations as of Dec. 31, 2009; and $32,431,133 was invested in securities with maturities of 90 days or less and $76,635,419 was invested in corporate obligations as of Dec. 31, 2008.

At Dec. 31, 2009, the fair market value of invested collateral was $83,121,000 of which $27,594,000 was included in cash and cash equivalents, $17,960,000 was included in U.S. government and agency obligations and $37,568,000 was included in corporate obligations in the Statement of Financial Position. At Dec. 31, 2008, the fair market value of invested collateral was $107,493,363, of which $32,389,154 was included in Cash and cash equivalents, $3,192,000 was included in U.S. government and agency obligations and $71,912,209 was included in Corporate bonds and other obligations in the Statement of Financial Position.

The Foundation recognized an unrealized loss of $1,735,000 and $4,765,189 for the years ended Dec. 31, 2009 and Dec. 31, 2008, respectively, in “Net change in fair value of investments” in the Statements in Activities related to changes in the value of collateral investments related to corporate obligations.