



THE WALLACE FOUNDATION

Financial Statements

December 31, 2016 and 2015

(With Independent Auditors' Report Thereon)



KPMG LLP
345 Park Avenue
New York, NY 10154-0102

Independent Auditors' Report

The Board of Directors
The Wallace Foundation:

We have audited the accompanying financial statements of The Wallace Foundation (the Foundation), which comprise the balance sheets as of December 31, 2016 and 2015, and the related statements of activities and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Wallace Foundation as of December 31, 2016 and 2015, and changes in its net assets and its cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.

KPMG LLP

June 22, 2017

THE WALLACE FOUNDATION

Balance Sheets

December 31, 2016 and 2015

Assets	2016	2015
Cash equivalents and cash	\$ 15,686,235	19,965,415
Investments (note 3)	1,414,141,780	1,428,093,141
Other assets and receivables	426,528	575,371
Fixed assets, net of accumulated depreciation of \$3,050,440 in 2016 and \$2,771,272 in 2015	<u>1,226,362</u>	<u>1,487,869</u>
Total assets	<u>\$ 1,431,480,905</u>	<u>1,450,121,796</u>
Liabilities and Net Assets		
Liabilities:		
Accrued expenses and other payables	\$ 1,632,307	2,220,758
Grants payable (note 4)	25,845,852	14,837,115
Deferred liabilities (note 5)	<u>6,626,267</u>	<u>6,420,780</u>
Total liabilities	34,104,426	23,478,653
Net assets – unrestricted	<u>1,397,376,479</u>	<u>1,426,643,143</u>
Total liabilities and net assets	<u>\$ 1,431,480,905</u>	<u>1,450,121,796</u>

See accompanying notes to financial statements.

THE WALLACE FOUNDATION

Statements of Activities

Years ended December 31, 2016 and 2015

	2016	2015
Revenues:		
Interest and dividends	\$ 8,437,509	9,919,777
Realized gains	30,288,940	73,694,424
Total investment income	38,726,449	83,614,201
Investment fees	(1,378,499)	(1,583,268)
Excise and income taxes (note 6)	(2,167,259)	(427,100)
Total investment expenses	(3,545,758)	(2,010,368)
Unrealized gains (losses), net of deferred tax (note 6)	21,198,875	(73,544,041)
Contributions	1,867	39
Net revenues	56,381,433	8,059,831
Expenses:		
Grants and related activities	72,275,310	69,540,176
Operating expenses	13,372,787	13,022,895
Total expenses	85,648,097	82,563,071
Change in net assets	(29,266,664)	(74,503,240)
Net assets:		
Beginning of year	1,426,643,143	1,501,146,383
End of year	\$ 1,397,376,479	1,426,643,143

See accompanying notes to financial statements.

THE WALLACE FOUNDATION

Statements of Cash Flows

Years ended December 31, 2016 and 2015

	2016	2015
Cash flows from operating activities:		
Change in net assets	\$ (29,266,664)	(74,503,240)
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Unrealized gains on investments	21,612,319	74,714,476
Realized gains on investments	(30,288,940)	(73,694,424)
Depreciation	311,576	310,382
Changes in assets and liabilities:		
Accrued investment income	117,467	620,570
Other assets and receivables	148,843	362,982
Accrued expenses and other payables	(588,451)	(158,568)
Grants payable	11,008,737	5,516,599
Deferred liabilities	205,487	(1,308,698)
Net cash used in operating activities	(26,739,626)	(68,139,921)
Cash flows from investing activities:		
Sales of investments	387,780,079	413,749,165
Purchases of investments	(365,269,564)	(343,695,083)
Purchases of fixed assets	(50,069)	(67,478)
Net cash provided by investing activities	22,460,446	69,986,604
Net (decrease) increase in cash equivalents and cash	(4,279,180)	1,846,683
Cash equivalents and cash at beginning of year	19,965,415	18,118,732
Cash equivalents and cash at end of year	\$ 15,686,235	19,965,415

See accompanying notes to financial statements.

THE WALLACE FOUNDATION

Notes to Financial Statements

December 31, 2016 and 2015

(1) Nature of Operations

The Wallace Foundation (the Foundation) is the philanthropic legacy of DeWitt and Lila Acheson Wallace, the co-founders of Reader's Digest. The mission of the Foundation is to foster improvements in learning and enrichment for disadvantaged children and the vitality of the arts for everyone. The Foundation seeks to meet two goals simultaneously: on the one hand, to create direct benefits for disadvantaged children and arts audiences while strengthening the organizations that serve them and, on the other hand, to spur beneficial changes for fields as a whole. The Foundation's approach is to identify areas where a gap in knowledge is a barrier to progress in the field, and then work to fill those knowledge gaps through grants for innovation, research, and communication. As a result, in addition to funding the direct delivery of services to the intended beneficiaries and capacity building at grantees, the Foundation gathers and publishes insights useful to policymakers and those who work in the areas where the Foundation concentrates its philanthropy. Today, the Foundation works in five areas: strengthening education leadership to improve student achievement, helping disadvantaged students gain more time for learning during the summer break and the school year, enhancing after-school opportunities, engaging more young people in high-quality arts learning experiences, and audience development for the arts.

(2) Summary of Significant Accounting Policies

(a) Basis of Accounting

The accounts of the Foundation are maintained on the accrual basis of accounting and in conformity with U.S generally accepted accounting principles.

(b) Income Taxes

The Foundation is exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code (the Code) and is a private foundation as defined in Section 509(a) of the Code. As required by the Code, the Foundation distributes annually at least 5% of the monthly average of the fair market value of its assets no later than the 12-month period following the end of its fiscal year.

The Foundation recognizes the effects of income tax positions only if those positions are more likely than not to be sustained in the future.

(c) Fair Value Measurements

Fair value is defined as the exchange price that would be received to sell an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The fair value hierarchy maximizes the use of observable inputs and minimizes the use of unobservable inputs when measuring fair value. The Foundation uses three levels of inputs to measure fair value:

Level 1: Quoted or published prices in active markets for identical assets. Level 1 assets include debt and equity securities that are traded in an active exchange market.

Level 2: Observable inputs other than Level 1 prices such as quoted or published prices for similar assets; prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets.

THE WALLACE FOUNDATION

Notes to Financial Statements

December 31, 2016 and 2015

Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the asset. Level 3 assets include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

The classification of investments in the fair value hierarchy is not necessarily an indication of the risks, liquidity, or degree of difficulty in estimating the fair value of each investment's underlying assets and liabilities.

Fair value estimates are made at a specific point in time, based on available market information and judgments about the financial instrument, including estimates of timing, amount of expected future cash flows, and the credit standing of the issuer. In some cases, the fair value estimates cannot be substantiated by comparison to independent markets. In addition, the disclosed fair value may not be realized in the immediate settlement of the financial asset. The disclosed fair values do not reflect any premium or discount that could result from offering for sale at one time an entire holding of a particular financial asset.

Potential taxes and other expenses that would be incurred in an actual sale or settlement are not reflected in amounts disclosed.

(d) Investments

Investments in equity securities with readily determinable fair values are reported at fair value based on quoted market prices or published NAV. Investments in debt securities are measured using quoted market prices where available. If quoted market prices for debt securities are not available, the fair value is determined using an income approach valuation technique that considers, among other things, rates currently observed in publicly traded markets for debt of similar terms to companies with comparable credit risk, the issuer's credit spread, and illiquidity by sector and maturity.

The Foundation follows the accounting standards of Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Subtopic 820-10-35-59, *Fair Value Measurement and Disclosures – Fair Value Measurements of Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*. This allows for the estimation of the fair value of investments in investment companies for which the investment does not have a readily determinable fair value using net asset value (NAV) per share or its equivalent. Those estimated fair values may differ significantly from the values that would have been used had a ready market for these securities existed.

(e) Fixed Assets

Fixed assets consist of furniture, fixtures, equipment, and leasehold improvements. All assets are depreciated on a straight-line basis over the estimated useful lives of the assets. Computers are depreciated over 3 years, office equipment is depreciated over 5 years, and furniture and fixtures are depreciated over 15 years. Leasehold improvements are depreciated over the life of the lease or the estimated life of the leasehold improvement, whichever is shorter.

THE WALLACE FOUNDATION

Notes to Financial Statements

December 31, 2016 and 2015

(f) Grants

Grants are reported as an expense and liability of the Foundation when approved by the Foundation's board of directors or the president, under authority delegated by the board of directors, and communicated to the grantee. Payments due in more than one year are discounted to present value.

(g) Cash Equivalents

Cash equivalents represent short-term investments with original maturities of three months or less at the time of purchase, except for those short-term investments managed by the Foundation's investment managers as part of their long-term investment strategies.

(h) 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.

(i) Reclassifications

There were reclassifications made to certain 2015 amounts to conform with the current year presentation.

(3) Investments

(a) Fair Value Hierarchy

The following tables present the Foundation's fair value hierarchy for investments, the only financial instruments measured at fair value on an annual basis, as of December 31, 2016 and 2015. Investments measured using the net asset value per share practical expedient are included in the total fair value column only and are not disclosed within the fair value hierarchy levels:

	2016			
	Total fair value	Level 1	Level 2	Level 3
Growth – market stocks:				
Direct ownership:				
International	\$ 61,790,056	61,790,056	—	—
Mutual fund:				
Global	30,666,368	30,666,368	—	—
	<u>92,456,424</u>	<u>92,456,424</u>	<u>—</u>	<u>—</u>
Commingled stock funds:				
United States	95,152,183	95,152,183	—	—
International	51,386,002	51,386,002	—	—
Global	81,266,205	81,266,205	—	—
	<u>227,804,390</u>	<u>227,804,390</u>	<u>—</u>	<u>—</u>
Growth total	<u>320,260,814</u>	<u>320,260,814</u>	<u>—</u>	<u>—</u>

THE WALLACE FOUNDATION

Notes to Financial Statements

December 31, 2016 and 2015

	2016			
	Total fair value	Level 1	Level 2	Level 3
Diversifying – bond funds:				
Mutual fund:				
Global	\$ 69,004,765	69,004,765	—	—
Commingled fund	523,695	—	—	523,695
Diversifying total	<u>69,528,460</u>	<u>69,004,765</u>	<u>—</u>	<u>523,695</u>
Inflation hedges – market:				
Direct ownership:				
REIT	22,112,039	22,112,039	—	—
Mutual funds:				
United States government/agency	1,109,777	1,109,777	—	—
Public energy fund	<u>16,259,627</u>	<u>16,259,627</u>	<u>—</u>	<u>—</u>
Inflation hedges total	<u>39,481,443</u>	<u>39,481,443</u>	<u>—</u>	<u>—</u>
Deflation hedges – fixed income:				
Direct ownership:				
United States government/ agency	60,791,825	—	60,791,825	—
Mutual funds:				
United States corporate and other	<u>7,315,057</u>	<u>7,315,057</u>	<u>—</u>	<u>—</u>
Deflation hedges – fixed income total	<u>68,106,882</u>	<u>7,315,057</u>	<u>60,791,825</u>	<u>—</u>
Other:				
Short-term investments	10,649,337	10,649,337	—	—
Accrued investment loss	(176,002)	(176,002)	—	—
Receivables for investments sold, net	<u>648,610</u>	<u>648,610</u>	<u>—</u>	<u>—</u>
Total	508,499,544	\$ <u><u>447,184,024</u></u>	<u><u>60,791,825</u></u>	<u><u>523,695</u></u>
Investments measured using net asset value (or its equivalent):				
Growth – market stocks:				
Commingled stock funds	161,797,887			
Growth – hedge funds:				
Multistrategy	90,085,517			
Long/short equity	119,856,048			
Credit-redeemable	52,405,197			
Credit-nonredeemable	43,892,878			
Growth – private equity funds	226,797,332			
Diversifying – opportunistic:				
Global macro discretionary	39,899,462			

THE WALLACE FOUNDATION

Notes to Financial Statements

December 31, 2016 and 2015

		2016			
		Total			
		fair value	Level 1	Level 2	Level 3
Global macro systematic	\$	47,219,958			
Relative value		18,639,498			
Inflation hedges – market:					
Commodity fund		13,656,831			
Public energy fund		15,514,939			
Inflation hedges – private:					
Private energy funds		63,037,281			
Private real estate funds		12,839,408			
Total investments	\$	<u>1,414,141,780</u>			
		2015			
		Total			
		fair value	Level 1	Level 2	Level 3
Growth – market stocks:					
Direct ownership:					
International	\$	57,819,590	57,819,590	—	—
Mutual fund:					
Global		30,161,544	30,161,544	—	—
		<u>87,981,134</u>	<u>87,981,134</u>	<u>—</u>	<u>—</u>
Commingled stock funds:					
United States		85,001,327	85,001,327	—	—
International		63,062,166	63,062,166	—	—
Global		52,629,043	52,629,043	—	—
		<u>200,692,536</u>	<u>200,692,536</u>	<u>—</u>	<u>—</u>
Growth total		<u>288,673,670</u>	<u>288,673,670</u>	<u>—</u>	<u>—</u>
Diversifying – opportunistic:					
Mutual fund:					
Asset allocation		29,425,415	29,425,415	—	—
Diversifying – bond funds:					
Mutual fund:					
Global		63,472,702	63,472,702	—	—
Commingled fund		645,940	—	—	645,940
Diversifying total		<u>93,544,057</u>	<u>92,898,117</u>	<u>—</u>	<u>645,940</u>
Inflation hedges – market:					
Direct ownership:					
REIT		20,746,649	20,746,649	—	—
Mutual funds:					
United States government/agency		1,064,117	1,064,117	—	—

THE WALLACE FOUNDATION

Notes to Financial Statements

December 31, 2016 and 2015

	2015			
	<u>Total fair value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Public energy Fund	\$ 18,336,229	18,336,229	—	—
Inflation hedges total	<u>40,146,995</u>	<u>40,146,995</u>	<u>—</u>	<u>—</u>
Deflation hedges – fixed income:				
Direct ownership:				
United States government/ agency	69,190,014	—	69,190,014	—
Mutual funds:				
United States corporate and other	<u>201,289</u>	<u>201,289</u>	<u>—</u>	<u>—</u>
Deflation hedges – fixed income total	69,391,303	201,289	69,190,014	—
Other:				
Short-term investments	10,018,564	10,018,564	—	—
Accrued investment loss	(58,535)	(58,535)	—	—
Receivables for investments sold, net	<u>13,783,247</u>	<u>13,783,247</u>	<u>—</u>	<u>—</u>
Total	515,499,301	\$ <u>445,663,347</u>	<u>69,190,014</u>	<u>645,940</u>
Investments measured using net asset value (or its equivalent):				
Growth – market stocks:				
Commingled stock funds	183,045,450			
Growth – hedge funds:				
Multistrategy	84,064,047			
Long/short equity	110,501,686			
Credit-redeemable	56,591,975			
Credit-nonredeemable	32,872,391			
Growth – private equity funds	232,560,759			
Diversifying – opportunistic:				
Global macro discretionary	75,750,054			
Global macro systematic	30,371,176			
Relative value	23,888,933			
Inflation hedges – market:				
Commodity fund	18,667,321			
Inflation hedges – private:				
Private energy funds	44,991,278			
Private real estate funds	<u>19,288,770</u>			
Total investments	\$ <u>1,428,093,141</u>			

Short-term investments include money market funds, U.S. government securities, and cash managed by the Foundation's investment managers as part of their long-term investment strategies.

THE WALLACE FOUNDATION

Notes to Financial Statements

December 31, 2016 and 2015

The following tables present reconciliations for all Level 3 assets measured at fair value at December 31, 2016 and 2015:

	2016						
	Beginning balance	Transfer	Realized gain (losses)	Unrealized gain (losses)	Purchases	Settlements	Ending balance
Diversifying-fixed income – commingled fund	\$ 645,940	—	54,328	(30,621)	—	(145,952)	523,695
Total	<u>\$ 645,940</u>	<u>—</u>	<u>54,328</u>	<u>(30,621)</u>	<u>—</u>	<u>(145,952)</u>	<u>523,695</u>

	2015						
	Beginning balance	Transfer	Realized gain (losses)	Unrealized gain (losses)	Purchases	Settlements	Ending balance
Diversifying-fixed income – commingled fund	\$ 877,417	—	104,368	(80,430)	—	(255,415)	645,940
Total	<u>\$ 877,417</u>	<u>—</u>	<u>104,368</u>	<u>(80,430)</u>	<u>—</u>	<u>(255,415)</u>	<u>645,940</u>

The Foundation recognizes transfers between levels of the fair value hierarchy on the date of the event or change in circumstance that caused the transfer. There were no transfers among Levels 1, 2 or 3 during the years ended December 31, 2016 and 2015.

(b) Portfolio Liquidity

The Foundation reviews the liquidity of its investments to ensure that it is able to meet its cash needs for grants, operating expenses, and capital calls. As of December 31, 2016, the Foundation had investments of \$507.6 million that could be sold on a daily basis under normal market conditions. This included \$10.6 million in a money market fund, \$144.7 million in direct ownership investments held in separate accounts with the Foundation's custodial trustee, \$108.1 million in mutual fund investments, \$16.3 million in a public energy fund, which is part of the Foundation's inflation hedge portfolio, \$81.3 million in a global commingled stock fund, \$51.4 million in an international commingled stock fund, and \$95.2 million in a U.S. commingled stock fund.

THE WALLACE FOUNDATION

Notes to Financial Statements

December 31, 2016 and 2015

(c) Strategies of Commingled, Hedge, Inflation Hedge, and Private Equity Funds

The following tables list the investment strategies, redemption terms, and assets for commingled, hedge, inflation hedge, and private equity funds measured at fair value as of December 31, 2016 and 2015:

	2016			
	<u>Total fair value</u>	<u>Unfunded commitments</u>	<u>Redemption dates per year</u>	<u>Redemption notice period</u>
Growth – market stocks:				
Commingled stock funds:				
United States	\$ 45,479,397	—	Biennial	90 days
International	<u>116,318,490</u>	<u>—</u>	Monthly/Daily	6/30 days
Total	<u>161,797,887</u>	<u>—</u>		
Growth – hedge funds:				
Multistrategy	90,085,517	—	Semi-Annually	60/90 days
Long/short equity	119,856,048	—	Quarterly/Annually	45/60 days
Credit – redeemable	52,405,197	—	Quarterly/Annually	60 days
Credit – nonredeemable	<u>43,892,878</u>	<u>11,000,000</u>	None	N/A
Total	<u>306,239,640</u>	<u>11,000,000</u>		
Growth – private equity funds	226,797,332	91,609,534	None	N/A
Diversifying – opportunistic:				
Global macro discretionary	39,899,462	—	Monthly	30 days
Global macro systematic	47,219,958	—	Monthly/Quarterly	4/5/30 days
Relative value	<u>18,639,498</u>	<u>—</u>	Quarterly	65 days
Total	<u>105,758,918</u>	<u>—</u>		
Inflation hedges – market:				
Commodity fund	13,656,831	—	Monthly	30 days
Public energy fund	<u>15,514,939</u>	<u>—</u>	Quarterly	60 days
Total	<u>29,171,770</u>	<u>—</u>		
Inflation hedges – private:				
Private energy funds	63,037,281	20,561,451	None	N/A
Private real estate funds	<u>12,839,408</u>	<u>2,413,337</u>	None	N/A
Total	<u>75,876,689</u>	<u>22,974,788</u>		
Total	\$ <u>905,642,236</u>	<u>125,584,322</u>		

THE WALLACE FOUNDATION

Notes to Financial Statements

December 31, 2016 and 2015

	2015			
	<u>Total fair value</u>	<u>Unfunded commitments</u>	<u>Redemption dates per year</u>	<u>Redemption notice period</u>
Growth – market stocks:				
Commingled stock funds:				
United States	\$ 75,512,524	—	Biennial	90 days
International	107,532,926	—	Monthly/Daily	6/30 days
Total	<u>183,045,450</u>	<u>—</u>		
Growth – hedge funds:				
Multistrategy	84,064,047	—	Annually	45–180 days
Long/short equity	110,501,686	—	Quarterly/Annually	45/60 days
Credit – redeemable	56,591,975	—	Quarterly/Annually	60 days
Credit – nonredeemable	32,872,391	—	None	N/A
Total	<u>284,030,099</u>	<u>—</u>		
Growth – private equity funds	232,560,759	112,306,350	None	N/A
Diversifying – opportunistic:				
Global macro discretionary	75,750,054	—	Monthly	30/31 days
Global macro systematic	30,371,176	—	Monthly	4/5 days
Relative value	23,888,933	—	Quarterly	65 days
Total	<u>130,010,163</u>	<u>—</u>		
Inflation hedges – market:				
Commodity fund	18,667,321	—	Monthly	30 days
Total	<u>18,667,321</u>	<u>—</u>		
Inflation hedges – private:				
Private energy funds	44,991,278	40,724,319	None	N/A
Private real estate funds	19,288,770	2,545,022	None	N/A
Total	<u>64,280,048</u>	<u>43,269,341</u>		
Total	<u>\$ 912,593,840</u>	<u>155,575,691</u>		

The following provides details for the investment strategies as of December 31, 2016 listed above:

(i) *Growth – Market Stocks*

Commingled Stock Funds

This includes \$161.8 million invested in three funds that invest in publicly traded common stock.

THE WALLACE FOUNDATION

Notes to Financial Statements

December 31, 2016 and 2015

(ii) *Growth – Hedge Funds*

Multistrategy

This consists of \$90.1 million invested in two hedge funds, of which \$71 million is redeemable by the Foundation and \$19.1 million is invested in private investments that will not be distributed to the Foundation until they are sold by the funds' managers at their discretion as market opportunities arise. These hedge funds invest in equity, fixed income, and derivative investments and vary their investment strategies in response to changing market opportunities. As of December 31, 2016, the Foundation's combined investments in these funds included 46% equity strategies, 12% credit strategies, 15% private investments and 27% cash.

Long/Short Equity

This includes \$119.9 million invested in three hedge funds that invest in publicly traded equity securities using a combination of long and short positions.

Credit – Redeemable

This includes \$52.4 million invested in two hedge funds that can be redeemed by the Foundation that invest primarily in publicly traded debt securities purchased at discounts to par value, including publicly traded bonds, bank debt, residential and commercial mortgage-backed securities, and other asset-backed securities.

Credit – Nonredeemable

This consists of \$43.9 million invested in two hedge funds with structures similar to private equity that make distributions to investors at the manager's discretion and are expected to fully distribute their assets over the next four to eight years approximately. These funds invest in publicly traded and private debt securities purchased at discounts to par value.

(iii) *Growth – Private Equity Funds*

This includes \$226.8 million invested in 30 funds that make distributions to investors at the managers' discretion and are expected to fully distribute their assets over the next 10 years approximately. As of December 31, 2016, the Foundation's combined investments in these funds includes 14% in seven primary funds of funds that invest in a diversified portfolio of buyout and venture capital funds, 35% in eleven secondary funds of funds that purchase interests in buyout and venture capital funds on a secondary basis at discounts to net asset value, 32% in eight venture capital funds that invest directly in technology and media companies, and 19% in four buyout funds that invest in specific sectors.

(iv) *Diversifying – Opportunistic*

Global Macro Discretionary

This includes \$39.9 million invested in two hedge funds. These funds invest in a range of strategies that analyze movements in underlying economic variables and predict the impact these have on equity, fixed income, hard currency, and commodity markets.

THE WALLACE FOUNDATION

Notes to Financial Statements

December 31, 2016 and 2015

Global Macro Systematic

This includes \$47.2 million invested in two hedge funds that invest in strategies that rely on mathematical, algorithmic models that analyze movements in global economic variables or prices. Some of these models seek to predict the impact of these variables on equity, fixed income, currency and commodity markets. Other models seek to identify trends in prices.

Relative Value

This includes \$18.6 million invested in a hedge fund that invests in a range of strategies that analyze spreads between securities that share financial and economic characteristics to identify deviations from historical relationships. These investments benefit when discrepancies in these spreads are recognized by the market.

(v) Inflation Hedges – Market

Commodity Fund

This includes \$13.7 million in a fund that invests on a global basis in publicly traded common stock and futures related to investments in energy, metals, grains, cotton, cocoa, sugar, and other commodities.

Public Energy Funds

This includes \$15.5 million invested in a fund that invests on a global basis in the publicly traded common stock of energy companies.

(vi) Inflation Hedges – Private

Private Energy Funds

This consists of \$63 million in ten funds that make distributions to investors at the managers' discretion and are expected to fully distribute their assets over the next ten years approximately. As of December 31, 2016, the Foundation's combined investments in these funds included 19% in three private energy funds of funds that invest in diversified portfolios of direct private energy funds and 81% in seven direct private energy funds that invest in companies that acquire or develop natural resource reserves, power generation facilities, and energy infrastructure assets.

Private Real Estate Funds

This includes \$12.8 million invested in three funds that make distributions to investors at the managers' discretion and are expected to fully distribute their assets over the next 10 years approximately. These funds invest directly in real estate properties that are not traded on public markets.

THE WALLACE FOUNDATION

Notes to Financial Statements

December 31, 2016 and 2015

(4) Grants Payable

At December 31, 2016 and 2015, grants scheduled to be paid in future years are as follows:

	2016	2015
Year:		
2017	\$ 16,372,551	7,713,120
2018	4,074,928	5,207,713
2019	3,030,813	1,219,928
2020	2,125,000	400,000
2021	545,000	—
	26,148,292	14,540,761
Discount to present value (based on interest rates from 0.75% to 1.87% for 2016 and 0.26% to 1.55% for 2015)	(302,440)	(203,646)
	\$ 25,845,852	14,337,115

(5) Deferred Liabilities

At December 31, 2016 and 2015, deferred liabilities consisted of the following:

	2016	2015
Federal excise tax (note 6)	\$ 5,450,809	5,037,365
5 Penn Plaza landlord incentives	1,175,458	1,383,415
	\$ 6,626,267	6,420,780

(6) Federal Excise Tax

As a private foundation, the Foundation is normally subject to a federal excise tax equal to 2% of its net investment income for tax purposes. However, under Section 4940(e) of the Code, this tax is reduced to 1% if certain conditions are met. The Foundation's current taxes are estimated at 2% and 1% of net investment income for December 31, 2016 and 2015, respectively. The current federal excise tax amounted to \$746,959 and \$820,309 for the years ended December 31, 2016 and 2015, respectively.

The Foundation records a liability for deferred federal excise tax at the 2% rate on the total unrealized appreciation in the fair value of investments. The federal excise tax will be paid as realized gains are reported for tax purposes. The unrealized gains on investments are reported net of the deferred federal excise tax revenue/(expense) of \$413,444 and \$(1,170,434) for the years ended December 31, 2016 and 2015, respectively, on the statements of activities.

THE WALLACE FOUNDATION

Notes to Financial Statements

December 31, 2016 and 2015

(7) Lease Commitments

The Foundation occupies office space under a lease agreement expiring in 2021.

The Foundation's total contractual lease commitments are as follows:

	<u>5 Penn Plaza</u>
Year:	
2017	\$ 1,031,000
2018	1,101,000
2019	1,115,000
2020	1,115,000
2021	<u>186,000</u>
	<u>\$ 4,548,000</u>

During the years ended December 31, 2016 and 2015, rent expense, including escalations, was \$979,875 and \$962,661, respectively.

(8) Pension Plans

The Foundation provides a defined-contribution retirement plan for all eligible employees, whereby the Foundation contributes 15% of a participant's eligible earnings on an annual basis. In addition, the Foundation provides a supplemental executive retirement plan for the benefit of certain eligible employees. Total pension expense for the years ended December 31, 2016 and 2015 was \$1,106,922 and \$1,061,298, respectively.

(9) Subsequent Events

The Foundation evaluated events subsequent to the balance sheet date of December 31, 2016 through June 22, 2017, which was the date the financial statements were available to be issued, and determined there were no additional matters that are required to be disclosed.