

MARDAG FOUNDATION
FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2016 AND 2015

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YEARS ENDED DECEMBER 31, 2016 AND 2015**

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INDEPENDENT AUDITORS' REPORT

Board of Directors
Mardag Foundation
St. Paul, Minnesota

We have audited the accompanying financial statements of Mardag Foundation (a nonprofit organization), which comprise the statements of financial position as of December 31, 2016 and 2015, and the related statements of activities - unrestricted 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 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 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.

Board of Directors
Mardag Foundation

Opinion

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

CliftonLarsonAllen LLP

CliftonLarsonAllen LLP

Minneapolis, Minnesota
June 14, 2017

MARDAG FOUNDATION
STATEMENTS OF FINANCIAL POSITION
DECEMBER 31, 2016 AND 2015

| | 2016 | 2015 |
|--|---------------|---------------|
| ASSETS | | |
| Cash and Cash Equivalents | \$ 596,775 | \$ 688,821 |
| Investments, at Fair Value, Cost of \$48,894,963 in 2016 and \$48,242,981 in 2015 | 54,875,315 | 53,216,744 |
| Prepaid Tax Asset | 3,071 | 28,132 |
| Total Assets | \$ 55,475,161 | \$ 53,933,697 |
| LIABILITIES AND NET ASSETS | | |
| LIABILITIES | | |
| Accounts Payable | \$ 69,848 | \$ 48,639 |
| Grants Payable | 551,000 | 575,265 |
| Deferred Tax Liability | 88,083 | 75,105 |
| Total Liabilities | 708,931 | 699,009 |
| UNRESTRICTED NET ASSETS | 54,766,230 | 53,234,688 |
| Total Liabilities and Net Assets | \$ 55,475,161 | \$ 53,933,697 |

See accompanying Notes to Financial Statements.

MARDAG FOUNDATION
STATEMENTS OF ACTIVITIES - UNRESTRICTED
YEARS ENDED DECEMBER 31, 2016 AND 2015

| | 2016 | 2015 |
|--|----------------------|----------------------|
| REVENUE, GAINS, AND LOSSES | | |
| Investment Income, Net of Investment Expenses of \$191,975 and \$235,126 in 2016 and 2015, Respectively | \$ 593,435 | \$ 511,187 |
| Net Unrealized and Realized Gains (Losses), Net of Change in Deferred Excise Taxes of \$(12,978) and \$(55,934) in 2016 and 2015, Respectively | 3,683,070 | (446,256) |
| Other Income | 457 | 6,599 |
| Total Revenue, Gains, and Losses | 4,276,962 | 71,530 |
| EXPENSES | | |
| Program: | | |
| Grants | 2,486,819 | 2,325,399 |
| Program Expenses | 153,616 | 180,650 |
| Total Program | 2,640,435 | 2,506,049 |
| Management and General: | | |
| Administrative Expenses | 84,454 | 72,659 |
| Federal Excise Tax | 20,531 | 32,815 |
| Total Management and General | 104,985 | 105,474 |
| Total Expenses | 2,745,420 | 2,611,523 |
| CHANGE IN NET ASSETS | 1,531,542 | (2,539,993) |
| Unrestricted Net Assets - Beginning of Year | 53,234,688 | 55,774,681 |
| UNRESTRICTED NET ASSETS - END OF YEAR | \$ 54,766,230 | \$ 53,234,688 |

See accompanying Notes to Financial Statements.

MARDAG FOUNDATION
STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2016 AND 2015

| | 2016 | 2015 |
|--|--------------|----------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Change in Net Assets | \$ 1,531,542 | \$ (2,539,993) |
| Adjustments to Reconcile Change in Net Assets to Net Cash Used by Operating Activities: | | |
| Net Realized and Unrealized (Gains) Losses in Market Value of Investments | (3,683,070) | 446,256 |
| (Increase) Decrease in: | | |
| Interest and Dividends Receivable | - | (421) |
| Prepaid Tax Asset | 25,061 | (28,132) |
| Increase (Decrease) in: | | |
| Accounts Payable | 21,209 | (18,545) |
| Grants Payable | (24,265) | (192,362) |
| Excise Tax Payable | - | (122) |
| Deferred Tax Liability | 12,978 | (55,934) |
| Net Cash Used by Operating Activities | (2,116,545) | (2,389,253) |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Proceeds from Sale of Investments | 2,670,000 | 3,250,000 |
| Reinvestment of Investment Income | (645,501) | (497,942) |
| Net Cash Provided by Investing Activities | 2,024,499 | 2,752,058 |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | (92,046) | 362,805 |
| Cash and Cash Equivalents - Beginning of Year | 688,821 | 326,016 |
| CASH AND CASH EQUIVALENTS - END OF YEAR | \$ 596,775 | \$ 688,821 |
| SUPPLEMENTAL INFORMATION | | |
| Cash Paid for Taxes | \$ 797 | \$ 55,000 |

See accompanying Notes to Financial Statements.

MARDAG FOUNDATION
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2016 AND 2015

NOTE 1 SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

Mardag Foundation (the Foundation) is an exempt private foundation that has a strategic focus on enhancing quality of life, inspiring learning, revitalizing communities and promoting access to the arts across Minnesota. Through grant making, the Foundation uses its resources to support the work of nonprofit organizations on projects that align with its strategic focus and that serve people and communities across Minnesota.

Financial Statement Presentation

The Foundation's financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America. Net assets and revenues, gains, and losses are classified based on donor imposed restrictions. Amounts for each three classes of net assets – permanently restricted, temporarily restricted and unrestricted, if applicable – are displayed in the financial statements. In 2016 and 2015, the Foundation had no temporarily or permanently restricted net assets.

Cash and Cash Equivalents

For the purposes of presenting the statement of cash flows, the Foundation considers all short-term investments purchased with an original maturity of three months or less to be cash equivalents.

Investments

The Foundation owns a percentage of a private investment partnership organized to provide its members a means to obtain unified professional management for their investments.

Marketable securities are reported at fair value based upon quoted market prices or, when quotes are not available, are valued on the basis of comparable financial instruments.

Limited marketability investments, which principally include private equities, absolute return investments, and real estate, are valued at the quoted market price for securities for which market quotations are readily available or an estimate of value (fair value) as determined in good faith by the general partner. Because these investments are not readily marketable, their estimated 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.

In general, investments are exposed to various risks, such as interest rate, credit and overall market volatility risk. Due to the level of risk associated with certain investments, it is reasonably possible that changes in the values of the investments will occur in the near term and that such changes could materially affect the investment balances and the amounts reported in the statements of financial position.

MARDAG FOUNDATION
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2016 AND 2015

NOTE 1 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Investment and Spending Policies

The Foundation has adopted investment and spending policies for assets that seek to maintain the purchasing power of the assets.

To achieve its investment objectives over the long periods of time, the Investment Partnership has adopted an investment strategy that invests in domestic equities, international equities, private capital, fixed income, absolute return investments and real assets. The majority of assets are invested in equity or equity like securities. Fixed income, real assets and absolute return investments are used to lower short-term volatility. Diversification by asset class, investment style, investment manager, etc. is employed to avoid undue risk concentration and enhance total return. The primary performance objective is to achieve an annualized total rate of return, net of investment fees, that is equal to or greater than 5% plus inflation measured over a three to five-year period of time.

The Foundation is subject to the distribution requirements of the Internal Revenue Code. Accordingly, within one year after the end of each fiscal year, the Foundation must distribute 5% of the average market value of its assets as defined.

Derivative Financial Instruments

The investment partnership's investment strategy incorporates certain financial instruments, which involve, to varying degrees, elements of market risk and credit risk. These financial instruments may include equity, fixed income and foreign currency futures and options contracts, and foreign currency forward contracts. The investment partnership uses derivatives to minimize the exposure of certain of its investments to adverse fluctuation in financial and currency markets, thus reducing portfolio risk. The investment partnership has not designated any of its derivative financial instruments as hedging instruments.

Grants Payable

Grants are recorded as expense when approved by the Foundation's board of directors. Conditional grants are recorded when the conditions have been substantially met.

MARDAG FOUNDATION
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2016 AND 2015

NOTE 1 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Fair Value Measurements

The Foundation follows an accounting standard that defines fair value, establishes a framework for measuring fair value, establishes a fair value hierarchy based on the quality of inputs used to measure fair value, and requires expanded disclosures about fair value measurements. The Foundation has categorized its investments, based on the priority of the inputs to the valuation technique, into a three-level fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). If the inputs used to measure the financial instruments fall within different levels of the hierarchy, the categorization is based on the lowest level input that is significant to the fair value measurement of the instrument.

Financial assets recorded on the statement of financial position are categorized based on the inputs to the valuation techniques as follows:

Level 1 – Financial assets and liabilities are valued using inputs that are unadjusted quoted prices in active markets accessible at the measurement date of identical financial assets and liabilities. The inputs include those traded on an active exchange, such as the New York Stock Exchange, as well as U.S. Treasury and other U.S. government and agency mortgage-backed securities that are traded by dealers or brokers in active over-the-counter markets. Level 1 includes various mutual funds, collective funds, and U.S. Treasury futures.

Level 2 – Financial assets and liabilities are valued based on quoted prices for similar assets, or inputs that are observable, either directly or indirectly for substantially the full term through corroboration with observable market data. Level 2 includes private collateralized mortgage obligations, municipal bonds, equity futures and corporate debt securities.

Level 3 – Financial assets and liabilities are valued using pricing inputs which are unobservable for the asset, inputs that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset. Level 3 includes private equity, venture capital, hedge funds and real estate.

Use of Estimates

The Foundation uses estimates and assumptions in preparing financial statements. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported revenues and expenses. Actual results could vary from those estimates.

**MARDAG FOUNDATION
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2016 AND 2015**

NOTE 1 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Tax Exempt Status

The Foundation has tax exempt status under Section 501(c)(3) of the Internal Revenue Code and Minnesota Statute. It has been classified as an organization that is a private foundation under the Internal Revenue Code and charitable contributions by donors are tax deductible. The Foundation files as a tax-exempt organization.

The Foundation follows accounting standards for uncertain tax positions. No liability has been recognized by the Foundation under this standard.

Reclassification

Certain prior amounts have been reclassified to conform to the current year presentation. Such reclassifications had no effect on net asset amounts previously reported.

Subsequent Events

In preparing these financial statements, the Foundation has evaluated events and transactions for potential recognition or disclosure through June 14, 2017, the date the financial statements were available to be issued.

NOTE 2 INVESTMENTS AND FAIR VALUE MEASUREMENTS

The Foundation uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. For additional information on how the Foundation values all other assets and liabilities refer to Note 1 – Significant Accounting Policies.

Assets Measured at Fair Value on a Recurring Basis:

| | 2016 | | | |
|---------------------------|---------|---------|---------------|---------------|
| | Level 1 | Level 2 | Level 3 | Total |
| Investment in Partnership | \$ - | \$ - | \$ 54,875,315 | \$ 54,875,315 |
| | 2015 | | | |
| | Level 1 | Level 2 | Level 3 | Total |
| Investment in Partnership | \$ - | \$ - | \$ 53,216,744 | \$ 53,216,744 |

MARDAG FOUNDATION
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2016 AND 2015

NOTE 2 INVESTMENTS AND FAIR VALUE MEASUREMENTS (CONTINUED)

Level 3 Assets

The following table provides a summary of changes in fair value of the Foundation's Level 3 financial assets for the years ended December 31:

| <u>Investment in Partnership</u> | <u>2016</u> | <u>2015</u> |
|--|----------------------|----------------------|
| Balance as of January 1 | \$ 53,216,744 | \$ 56,408,577 |
| Net Realized and Unrealized Gains (Losses) on Investments | 3,683,070 | (446,256) |
| Reinvestment of Investment Income | 645,501 | 504,423 |
| Proceeds from Sale of Investments | <u>(2,670,000)</u> | <u>(3,250,000)</u> |
| Balance as of December 31 | <u>\$ 54,875,315</u> | <u>\$ 53,216,744</u> |

NOTE 3 GRANTS PAYABLE

Unconditional grants approved but unpaid at year-end are reported as grants payable on the statement of financial position. Grants to be paid in more than one year are discounted using rates ranging between 1.6% and 2.2% in 2015. As of December 31, 2016, grants expected to be paid in future years was minimal; therefore, no discount was recognized. Unconditional grants payable at December 31, 2016 and 2015 are due as follows:

| | <u>2016</u> | <u>2015</u> |
|------------------------|-------------------|-------------------|
| Less than One Year | \$ 486,000 | \$ 505,000 |
| One Year to Five Years | 65,000 | 70,265 |
| Total | <u>\$ 551,000</u> | <u>\$ 575,265</u> |

At December 31, 2016 and 2015, the Foundation has approved grants of \$95,000 and \$230,050, respectively, which are subject to conditions and have not been reflected in the accompanying financial statements.

NOTE 4 FEDERAL EXCISE TAXES

The Foundation is subject to a 2% excise tax on its taxable investment income, which principally includes income from investments plus net realized capital gains (net capital losses for a year, however, are not deductible and cannot be carried back or forward). The excise tax on net investment income is reduced from 2% to 1% for any taxable year in which the Foundation's qualifying distributions meet certain requirements prescribed by Internal Revenue Code Section 4940(e). The Foundation met these requirements in 2015 and the current year's tax is based upon the 1% rate. Deferred federal excise taxes are based on a 1.5% tax rate supported by historical trends and arise from unrealized appreciation in the market value of investments.