

*Financial Statements and
Independent Accountants' Review Report*

THE NICHOLAS ENDOWMENT



As of and for the Years Ended December 31, 2016 and 2015

THE NICHOLAS ENDOWMENT

Table of Contents

	<u>Page</u>
Independent Accountants' Review Report	
Financial Statements	
Statements of Financial Position	3
Statements of Activities and Changes in Net Assets	4
Statements of Cash Flows	5
Notes to Financial Statements	6

INDEPENDENT ACCOUNTANTS' REVIEW REPORT

To the Board of Trustees
The Nicholas Endowment

We have reviewed the accompanying financial statements of The Nicholas Endowment (the "Endowment"), which comprise the statement of financial position as of December 31, 2016, and the related statements of activities and changes in net assets and cash flows for the year then ended, and the related notes to the financial statements. A review includes primarily applying analytical procedures to management's financial data and making inquiries of company management. A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, we do not express such an opinion.

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.

Accountants' Responsibility

Our responsibility is to conduct the review engagement in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the American Institute of Certified Public Accountants (AICPA). Those standards require us to perform procedures to obtain limited assurance as a basis for reporting whether we are aware of any material modifications that should be made to the financial statements for them to be in accordance with accounting principles generally accepted in the United States of America. We believe that the results of our procedures provide a reasonable basis for our conclusion.

Accountants' Conclusion

Based on our review, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in accordance with accounting principles generally accepted in the United States of America.

INDEPENDENT ACCOUNTANTS' REVIEW REPORT (CONTINUED)

Other Matter – Prior Year Audited Financial Statements

The Endowment's 2015 financial statements were audited by us and we expressed an unmodified opinion on them in our report dated May 8, 2017, but we have not performed any auditing procedures since that date.

Haskell & White LLP

HASKELL & WHITE LLP

Irvine, California
November 14, 2017

THE NICHOLAS ENDOWMENT

**Statements of Financial Position
As of December 31, 2016 and 2015**

ASSETS	<u>2016</u>	<u>2015</u>
Assets:		
Cash and cash equivalents	\$ 305,216	\$ 475,638
Investments, at fair value (Notes 1 and 2)	<u>35,986,019</u>	<u>35,524,390</u>
Total assets	<u>\$ 36,291,235</u>	<u>\$ 36,000,028</u>
 LIABILITIES AND NET ASSETS 		
Liabilities:		
Federal excise tax liabilities	<u>\$ 66,629</u>	<u>\$ 65,834</u>
Total liabilities	<u>66,629</u>	<u>65,834</u>
Net Assets:		
Unrestricted	<u>36,224,606</u>	<u>35,934,194</u>
Total net assets	<u>36,224,606</u>	<u>35,934,194</u>
Total liabilities and net assets	<u>\$ 36,291,235</u>	<u>\$ 36,000,028</u>

See accompanying notes to financial statements and independent accountants' review report.

THE NICHOLAS ENDOWMENT

Statements of Activities and Changes in Net Assets For the Years Ended December 31, 2016 and 2015

	2016	2015
Investment income:		
Interest, dividends and mutual fund distributions	\$ 647,580	\$ 707,268
Operating income from partnerships	410,652	148,039
Net realized (losses) gains on investments sold	(229,735)	2,195,922
Net change in unrealized gains (losses) on investments	1,156,289	(4,091,846)
Investment management and custodian fees	(89,266)	(101,919)
Federal excise tax (provision) benefit	(49,397)	44,622
	1,846,123	(1,097,914)
Expenses:		
Grants awarded (Note 1)	1,449,817	1,478,505
General and administrative	105,894	84,869
	1,555,711	1,563,374
Total expenses	1,555,711	1,563,374
Change in net assets	290,412	(2,661,288)
Net assets at beginning of the year	35,934,194	38,595,482
Net assets at end of the year	\$ 36,224,606	\$ 35,934,194

See accompanying notes to financial statements and independent accountants' review report.

THE NICHOLAS ENDOWMENT

**Statements of Cash Flows
For the Years Ended December 31, 2016 and 2015**

	<u>2016</u>	<u>2015</u>
Cash flows from operating activities		
Change in net assets	\$ 290,412	\$ (2,661,288)
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Net realized and unrealized (gains) losses on investments	(926,554)	1,895,924
Change in liabilities:		
Federal excise tax liabilities	<u>795</u>	<u>(75,927)</u>
Net cash used in operating activities	<u>(635,347)</u>	<u>(841,291)</u>
Cash flows from investing activities		
Proceeds from sale of investments and return of capital	2,198,071	10,185,847
Purchase of investments	<u>(1,733,146)</u>	<u>(9,605,809)</u>
Net cash provided by investing activities	<u>464,925</u>	<u>580,038</u>
Net change in cash and cash equivalents	(170,422)	(261,253)
Cash and cash equivalents, beginning of year	<u>475,638</u>	<u>736,891</u>
Cash and cash equivalents, end of year	<u><u>\$ 305,216</u></u>	<u><u>\$ 475,638</u></u>
<i>Supplemental disclosure of cash flow information:</i>		
Cash paid during the year for federal excise taxes	<u><u>\$ 43,102</u></u>	<u><u>\$ 26,215</u></u>

See accompanying notes to financial statements and independent accountants' review report.

THE NICHOLAS ENDOWMENT

Notes to Financial Statements December 31, 2016 and 2015

1. Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

The Nicholas Endowment (the “Endowment”) was established in 2002 to provide a perpetual base of funding to supported organizations and charities. The Endowment awards grants in the areas of science and education, performing and visual arts, and other selected causes.

Effective January 1, 2011, the Endowment was converted from a public charity to a private foundation. With this conversion, the minimum distribution of assets is based upon an assessment of the endowment value at the end of each year. The year ended December 31, 2011 was considered a grace year and the minimum distribution of assets assessment started with the year ended December 31, 2012. The Endowment was in compliance with the minimum distribution requirement for each of the years ended December 31, 2016 and 2015.

Basis of Presentation

The financial statements of the Endowment have been prepared on the accrual basis of accounting and on the basis of unrestricted, temporarily restricted and permanently restricted net assets. As of December 31, 2016 and 2015, all of the Endowment’s net assets are unrestricted. The statements of financial position are prepared using specialized accounting principles of Accounting Standards Codification (“ASC”) 958, *Not-for-Profit Entities*.

Use of Estimates

The process of preparing financial statements in conformity with accounting principles generally accepted in the United States of America requires the use of estimates and assumptions regarding certain types of assets, liabilities, revenues and gains, and expenses and losses. Such estimates primarily relate to fair value of investments that do not have readily determinable market values and unsettled transactions and events as of the date of the financial statements. Accordingly, actual results may differ from estimated amounts.

See accompanying independent accountants’ review report

THE NICHOLAS ENDOWMENT

Notes to Financial Statements (continued) December 31, 2016 and 2015

1. Nature of Operations and Summary of Significant Accounting Policies (continued)

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents may include, bank checking accounts, money market funds and highly-liquid debt instruments with maturities of three months or less when purchased.

Investments

Investments are presented at estimated fair value. Where available and appropriate, alternative investments, which generally do not have a readily determinable fair value, are valued using fund-provided net asset values per share of ownership interest (NAVs) as allowed under Financial Accounting Standards Board Accounting Standards Update No. 2009-12, *Fair Value Measurements and Disclosures (Topic 820): Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*.

The ultimate liquidation of alternative investments is restricted to certain time periods and is generally limited to sell to the fund manager or distributions from the fund. Due to the inherent uncertainty of valuation of nonmarketable and restricted investments, those estimated values may differ significantly from the values that would have been used had a ready market for the securities existed and the differences could be material.

Investments are exposed to various risks such as significant world events, interest rates, credit, and overall market volatility risks. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the fair value of investments will occur in the near-term and that such changes could materially affect the amounts reported in the statements of financial position.

Grants

Grant expense is recognized in the period the grant is approved by the Board of Trustees, provided the grant is not subject to significant future conditions. Conditional grants are recognized as grant expense and as a grant payable in the period in which the grantee meets the terms of the conditions. Grants payable that are expected to be paid in future years are recorded at the present value of expected future payments. At December 31, 2016 and 2015, the Endowment had no grants payable. For the years ended December 31, 2016 and 2015, grants expense totaled \$1,449,817 and \$1,478,505, respectively.

See accompanying independent accountants' review report

THE NICHOLAS ENDOWMENT

Notes to Financial Statements (continued) December 31, 2016 and 2015

1. Nature of Operations and Summary of Significant Accounting Policies (continued)

Taxes

The Endowment is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code (“IRC”) and corresponding state codes. However, the Endowment is subject to a federal excise tax because it is a private foundation in accordance with Internal Revenue Service regulations. The IRC imposes an excise tax on private foundations equal to 2% of net investment income, as defined by the IRC. The tax is reduced to 1% for foundations that meet certain distribution requirements under Section 4940(e) of the IRC.

The Endowment’s current provision for federal excise tax is based on a 1% rate for both of the years ended December 31, 2016 and 2015, while the deferred provision for federal excise tax on cumulative net unrealized gains is based on a 2% rate for the years ended December 31, 2016 and 2015. As of December 31, 2016, the Endowment has no current federal excise tax liability and an estimated deferred tax liability of \$66,629. As of December 31, 2015, federal excise tax liabilities aggregated \$65,834.

The Endowment determines whether tax positions of the Endowment are “more likely than not” to be sustained upon examination by the applicable taxing authority based on the technical merits of the positions. As of December 31, 2016 and 2015, the Endowment has analyzed its significant tax positions for all open tax years (in each respective jurisdiction) and has concluded that no reserve for uncertain tax positions is required.

Recent Accounting Pronouncements

In August 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standard Update No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. This update simplifies and improves how a not-for-profit organization classifies its net assets, as well as the information it presents in financial statements and notes about its liquidity, financial performance, and cash flows. The new standard will be effective for the Endowment for its year ending December 31, 2018, with early application permitted. Management is currently evaluating the impact of the adoption of this standard.

See accompanying independent accountants’ review report

THE NICHOLAS ENDOWMENT

Notes to Financial Statements (continued) December 31, 2016 and 2015

1. Nature of Operations and Summary of Significant Accounting Policies (continued)

Recent Accounting Pronouncements (continued)

In February 2016, the FASB issued guidance regarding leases, which requires lessees to recognize on the balance sheet a right-of-use asset, representing their right to use the underlying asset for the lease term, and a lease liability for all leases with terms greater than 12 months. The guidance also requires qualitative and quantitative disclosures designed to assess the amount, timing and uncertainty of cash flows arising from leases. The guidance requires the use of a modified retrospective transition approach, which includes a number of optional practical expedients that entities may elect to apply. The guidance is effective for the Endowment in 2020. Management does not expect this guidance to significantly impact the accompanying financial statements.

In May 2015, the FASB issued Accounting Standard Update No. 2015-07, *Fair Value Measurement: Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share*. The new guidance removes, from the fair value hierarchy, investments for which the practical expedient is used to measure fair value at net asset value (NAV). Instead, an entity is required to include those investments as a reconciling line item so that the total fair value amount of investments in the disclosure is consistent with the amount on the balance sheet. The Endowment expects to adopt this guidance for the year ending December 31, 2017 and apply it retrospectively for all comparative periods presented.

Subsequent Events

Events occurring subsequent to year end have been evaluated for possible adjustment to the financial statements or disclosure through November 14, 2017, which is the date the financial statements were available to be issued.

2. Investments

Investment Composition

The Endowment's investments measured at fair value as of December 31, 2016 and 2015 are comprised of the following:

See accompanying independent accountants' review report

THE NICHOLAS ENDOWMENT

Notes to Financial Statements (continued) December 31, 2016 and 2015

2. Investments

Investment Composition (continued)

	2016	2015
United States equities	\$ 11,582,838	\$ 10,737,172
Non-United States equities	8,467,203	8,221,958
Fixed income investments	7,621,786	7,515,834
Real asset funds	1,585,848	1,330,160
Hedge funds	5,206,205	6,188,996
Partnerships	1,522,139	1,530,270
	<u>\$ 35,986,019</u>	<u>\$ 35,524,390</u>

Fair Value Measurements

Fair value is defined as the price that the Endowment would receive to sell an asset, or pay to transfer a liability, in an orderly transaction between market participants at the measurement date. The Endowment utilizes a three-level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of an asset or liability. Inputs may be observable or unobservable and refer broadly to the assumptions that market participants would use in pricing the asset or liability. Observable inputs reflect the assumptions market participants would use in pricing the asset or liability based on market data obtained from sources independent of the reporting entity. Unobservable inputs reflect the Endowment's own assumptions about the assumptions that market participants would use in pricing the asset or liability developed based on the best information available under the circumstances. The three-tier hierarchy of inputs is summarized below.

Level 1 - inputs are quoted prices in active markets.

Level 2 - inputs are observable, directly or indirectly; fair value is primarily determined using models or other valuation methodologies that utilize market prices of similar securities as inputs to determine fair value.

Level 3 - inputs are unobservable and include situations where there is little, if any, market activity.

See accompanying independent accountants' review report

THE NICHOLAS ENDOWMENT

**Notes to Financial Statements (continued)
December 31, 2016 and 2015**

2. Investments (continued)

Fair Value Measurements (continued)

	2016			Total
	Level 1	Level 2	Level 3	
Equities	\$ 20,050,041	\$ -	\$ -	\$ 20,050,041
Fixed income	7,621,786	-	-	7,621,786
Real asset funds	1,585,848	-	-	1,585,848
Hedge funds	-	-	5,206,205	5,206,205
Partnerships	-	-	1,522,139	1,522,139
Total Investments	<u>\$ 29,257,675</u>	<u>\$ -</u>	<u>\$ 6,728,344</u>	<u>\$ 35,986,019</u>

	2015			Total
	Level 1	Level 2	Level 3	
Equities	\$ 18,959,130	\$ -	\$ -	\$ 18,959,130
Fixed income	7,515,834	-	-	7,515,834
Real asset funds	1,330,160	-	-	1,330,160
Hedge funds	-	-	6,188,996	6,188,996
Partnerships	-	-	1,530,270	1,530,270
Total Investments	<u>\$ 27,805,124</u>	<u>\$ -</u>	<u>\$ 7,719,266</u>	<u>\$ 35,524,390</u>

The fair value of equities, fixed income securities and real asset funds is based on quoted prices in active markets.

The Endowment has investments in hedge funds and partnerships that are classified as Level 3 investments, which are collectively referred to as “alternative” investments, whose values have been estimated by the Endowment in the absence of readily ascertainable market values. The Endowment’s estimate of fair value is generally based on the NAV provided by each alternative investment fund, supported by independently audited financial statements of the alternative investment fund, when available.

See accompanying independent accountants’ review report

THE NICHOLAS ENDOWMENT

Notes to Financial Statements (continued) December 31, 2016 and 2015

2. Investments (continued)

Fair Value Measurements (continued)

Changes in Level 3 assets measured at fair value for the years ended December 31, 2016 and 2015 are as follows:

	2016							Balance December 31, 2016
	Balance January 1, 2016	Net Operating Gains	Realized Losses	Change in Unrealized Losses	Purchases	Sales	Return of Capital	
Hedge funds	\$ 6,188,996	209,561	\$ -	\$ (137,843)	\$ -	\$ -	\$(1,054,509)	\$ 5,206,205
Partnerships	1,530,270	288,758	(6,370)	(99,657)	61,138	-	(252,000)	1,522,139
	<u>\$ 7,719,266</u>	<u>\$ 498,319</u>	<u>\$ (6,370)</u>	<u>\$ (237,500)</u>	<u>\$ 61,138</u>	<u>\$ -</u>	<u>\$(1,306,509)</u>	<u>\$ 6,728,344</u>

	2015							Balance December 31, 2015
	Balance January 1, 2015	Net Operating Gains (Losses)	Realized Gains	Change in Unrealized Gains (Losses)	Purchases	Sales	Return of Capital	
Hedge funds	\$ 6,328,396	\$ -	\$ -	\$ (139,400)	\$ -	\$ -	\$ -	\$ 6,188,996
Partnerships	1,786,042	-	113,385	62,872	291,098	(671)	(722,456)	1,530,270
	<u>\$ 8,114,438</u>	<u>\$ -</u>	<u>\$ 113,385</u>	<u>\$ (76,528)</u>	<u>\$ 291,098</u>	<u>\$ (671)</u>	<u>\$ (722,456)</u>	<u>\$ 7,719,266</u>

Risks and Uncertainties

The Endowment maintains its cash, cash equivalents, and a significant portion of its investments with high-credit quality financial institutions. At times, balances in these accounts exceed the Federal Deposit Insurance Corporation insurance limit of \$250,000 or the Securities Investor Protection Corporation insurance limit of \$500,000.

To address market risk of investments, the Endowment maintains a formal investment policy that sets out performance criteria, investment guidelines and requires review of the investment managers' performances. Investments are managed by multiple investment managers, who have responsibility for investing the funds in various investment alternatives. In addition, an investment consultant is also utilized to help oversee the performance of the investment portfolio and the achievement of investment objectives. The Endowment also has custody agreements with selected banks, which process disbursements at the direction of authorized staff and the board of trustees.

See accompanying independent accountants' review report

THE NICHOLAS ENDOWMENT

Notes to Financial Statements (continued) December 31, 2016 and 2015

2. Investments (continued)

Risks and Uncertainties (continued)

The Endowment's holdings in limited partnerships entail liquidity risk, as there is no readily available market for investments in limited partnerships. The underlying investments held within these partnerships are generally in privately held companies. There is no readily available market for such privately held companies, and investments in those may be subject to legal restrictions on transfer. As a result, there is no assurance that the Endowment will be able to realize liquidity for such investments in a specified time frame or in an amount equal to the amounts reported in these financial statements.

Investment Commitments

At December 31, 2016 and 2015, the Endowment had commitments to contribute additional capital to its partnership investments of approximately \$2,171,000 and \$1,405,000, respectively.

3. Related Party Transactions

The Endowment has a conflict of interest policy which covers relationships with trustees. The policy requires annual disclosures and discussion of potential conflicts at meetings, so that trustees may continue to serve the Endowment through their professional knowledge and expertise. Additionally, the policy requires a trustee to recuse him/herself from voting on matters when a potential conflict of interest may exist.

The Endowment has, and may continue to have, trustees who are employed by organizations that are supported by the Endowment. Total grants given to these organizations totaled \$190,000 and \$300,000 for the years ended December 31, 2016 and 2015, respectively. In addition, the Endowment also maintains an investment in a partnership that is managed by an organization that employed a trustee. The fair value of this partnership investment as of December 31, 2016 is \$840,000 and as of December 31, 2015 is \$768,000.

See accompanying independent accountants' review report