BILL & MELINDA GATES FOUNDATION

Financial Statements

December 31, 2003 and 2002

(With Independent Auditors' Report Thereon)

KPMG

KPMG LLP
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Independent Auditors' Report

The Trustee
Bill & Melinda Gates Foundation:

We have audited the accompanying statements of financial position of the Bill & Melinda Gates Foundation (the Foundation) as of December 31, 2003 and 2002 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 of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as 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 as of December 31, 2003 and 2002 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 of America.

KPMG LLP

March 18, 2004

BILL & MELINDA GATES FOUNDATION

Statements of Financial Position

December 31, 2003 and 2002

Assets	**2003**	**2002**
Cash and cash equivalents	$ 41,387,000	$ 91,044,000
Investments	27,558,570,000	24,663,692,000
Investments loaned under secured lending transactions	5,061,514,000	6,074,988,000
Investment sales receivable	679,220,000	336,702,000
Interest and dividends receivable	300,881,000	288,239,000
Federal excise tax refunds receivable	12,945,000	7,074,000
Program related investments receivable	1,440,000	—
Property and equipment, net	22,560,000	27,782,000
Total assets	$ 33,678,517,000	$ 31,489,521,000
Liabilities and Net Assets		
Liabilities:		
Accounts payable	$ 4,726,000	$ 4,651,000
Payable under investment loan agreements	5,158,317,000	6,227,466,000
Investment purchases payable	1,709,682,000	1,180,002,000
Accrued and other liabilities	15,583,000	7,791,000
Deferred excise taxes payable	26,034,000	12,109,000
Grants payable, net	1,672,868,000	1,495,255,000
Total liabilities	8,587,210,000	8,927,274,000
Net assets – unrestricted	25,091,307,000	22,562,247,000
Total liabilities and net assets	$ 33,678,517,000	$ 31,489,521,000

See accompanying notes to financial statements.

BILL & MELINDA GATES FOUNDATION

Statements of Activities

Years ended December 31, 2003 and 2002

		2003		2002
Change in net assets:				
Revenues and gains:				
Contributions	$	81,915,000	$	82,479,000
Investment income, net		3,928,204,000		1,965,411,000
Total revenues and gains		4,010,119,000		2,047,890,000
Expenses:				
Grants		1,359,635,000		977,977,000
Direct charitable expenses		32,836,000		29,198,000
Program and administrative expenses		54,534,000		45,958,000
Federal excise tax		34,054,000		44,101,000
Total expenses		1,481,059,000		1,097,234,000
Change in net assets		2,529,060,000		950,656,000
Unrestricted net assets, beginning of year		22,562,247,000		21,611,591,000
Unrestricted net assets, end of year	$	25,091,307,000	$	22,562,247,000

See accompanying notes to financial statements.

BILL & MELINDA GATES FOUNDATION

Statements of Cash Flows

Years ended December 31, 2003 and 2002

	2003	2002
Cash flows from operating activities:		
Change in net assets	$ 2,529,060,000	$ 950,656,000
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	8,783,000	6,493,000
Net realized and unrealized gain on sale of investments	(2,992,191,000)	(939,075,000)
Changes in operating assets and liabilities:		
Investment sales receivable	(342,518,000)	(242,056,000)
Interest and dividends receivable	(12,642,000)	9,778,000
Federal excise tax refunds receivable	(5,871,000)	(2,519,000)
Program related investment receivable	(1,440,000)	—
Accounts payable	75,000	(2,858,000)
Investment purchases payable	529,680,000	(51,175,000)
Accrued and other liabilities	7,792,000	4,128,000
Deferred excise taxes	13,925,000	13,464,000
Grants payable, net	177,613,000	(180,727,000)
Net cash used in operating activities	(87,734,000)	(433,891,000)
Cash flows from investing activities:		
Purchases of investments	(190,370,489,000)	(110,648,412,000)
Proceeds from sales of investments	190,467,802,000	110,793,895,000
Cash received (paid) under secured lending arrangements	(55,675,000)	110,202,000
Purchases of property and equipment	(3,561,000)	(7,063,000)
Net cash provided by investing activities	38,077,000	248,622,000
Net decrease in cash and cash equivalents	(49,657,000)	(185,269,000)
Cash and cash equivalents, beginning of year	91,044,000	276,313,000
Cash and cash equivalents, end of year	$ 41,387,000	$ 91,044,000
Supplemental disclosure of cash flow information:		
Cash paid during the year for excise taxes	$ 26,000,000	$ 33,150,000
Noncash contributions	81,915,000	82,479,000

See accompanying notes to financial statements.

(1) Organization

The Bill & Melinda Gates Foundation (the Foundation) is a tax exempt private foundation that supports charitable organizations in the areas of global health, education, libraries, and the Pacific Northwest. The Foundation's mission is to reduce global health inequities, support America's high schools to ensure that all students graduate ready for college, maintain access to computers and the Internet in public libraries, and support programs in the Pacific Northwest for vulnerable families.

The Foundation is organized as a charitable trust, and operates its main office in Seattle, Washington, with branch offices in Washington, D.C. and New Delhi, India.

(2) Summary of Significant Accounting Policies

(a) Basis of Financial Presentation

The accompanying financial statements have been prepared on the accrual basis of accounting.

The Foundation recognizes contributions, including unconditional promises to give, as revenue in the period received. Contributions, net assets, and changes therein are classified and reported based on the existence or absence of donor-imposed restrictions. For the years ended December 31, 2003 and 2002, all activities of the Foundation were classified as unrestricted due to the lack of donor-imposed restrictions.

(b) Cash and Cash Equivalents

Cash and cash equivalents consist of cash, money market funds, and highly liquid investments with original maturities of three months or less at the date of acquisition.

(c) Investments

Investments in equity securities with readily determinable fair values and all debt securities are stated at fair value. Fair value is determined based on quoted market prices. Private equities are stated at fair value as estimated by the general partner. Unrealized gains or losses on investments resulting from market fluctuations are recorded in the statement of activities in the period that such fluctuations occur.

Investment sales and purchases are recorded on a trade-date basis, which results in both investment receivables and payables on unsettled investment trades. Dividend income is recorded based upon the ex-dividend date, and interest income is recorded as earned on an accrual basis. Futures, forwards, and options contracts are marked to market with the change reflected in investment income.

(d) Property and Equipment

Property and equipment are recorded at cost and depreciated on a straight-line basis over the estimated useful lives of the respective assets or amortized over the terms of the respective leases, whichever is shorter, as follows:

Computers, printers, and software	3 years
Furniture and fixtures	10 years
Telecommunications equipment	3 years
Leasehold improvements	Over estimated useful life of the lease

(e) Grant Expenditures

Grant expenditures are recognized in the period the grant is approved, provided the grant is not subject to future contingencies. 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, 2003, grants payable were discounted using rates ranging from 3.25% to 5.5%.

(f) Contributed Goods and Services

The value of significant contributed goods is reflected as contributions in the accompanying financial statements.

Contributed services are recognized if the services received (a) create or enhance long-lived assets or (b) require specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not provided by donation. The value of contributed services recorded in the accompanying statement of activities, consisting primarily of investment management services to a related party, totaled $81,915,000 and $82,479,000 for the years ended December 31, 2003 and 2002, respectively. Contributed services are reflected as contributions revenue and partially a reduction of investment income and partially an addition to program and administrative expenses.

(g) Tax-Exempt Status

The Foundation is exempt from federal income taxes under Section 501(c)(3) and is classified as a private foundation under Section 509(a) of the Internal Revenue Code. The Foundation is subject to federal excise taxes.

(h) Functional Allocation of Expenses

The costs of providing the various programs and other activities have been allocated between direct charitable and program and administrative expenses in the accompanying statement of activities based on management's estimates. Direct charitable expenses are charitable costs, largely for the benefit of others, where the Foundation initiates and conducts the activity in part or in whole. Program and administrative expenses relate to general grant making and supporting activities.

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(i) ***U.S. Library Program Wind Down***

The Foundation applies Statement of Financial Accounting Standards No. 146, *Accounting for Costs Associated with Exit of Disposal Activities,* regarding the treatment of exit costs related to employee severance of the Foundation's U.S. Library program. Accordingly, discounted exit costs are spread between the wind down communication date and the final end date (see note 12).

(j) ***Use of Estimates***

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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.

(k) ***Reclassifications***

Certain reclassifications have been made to the 2002 amounts to conform to the 2003 presentation.

(3) Functional Allocation of Expenses

At December 31, 2003 and 2002, the Foundation's functional allocation of expenses is represented as follows:

	2003	2002
Program expenses:		
Health programs	$ 653,454,000	$ 541,985,000
Education programs	648,009,000	224,828,000
Library programs	31,507,000	51,787,000
Special projects	14,593,000	63,794,000
Pacific Northwest and other programs	58,981,000	134,288,000
Total program expenses	1,406,544,000	1,016,682,000
Management and general expenses	40,461,000	36,451,000
Excise tax expense	34,054,000	44,101,000
Total expenses	$ 1,481,059,000	$ 1,097,234,000

(4) Investments

At December 31, 2003 and 2002, the Foundation's investments consist of the following:

	2003	2002
Short-term investments	$ 6,434,316,000	$ 7,907,589,000
Bonds, notes, and other	20,948,348,000	19,972,912,000
Equities	5,237,420,000	2,858,179,000
	32,620,084,000	30,738,680,000
Less investments loaned under secured lending transactions	(5,061,514,000)	(6,074,988,000)
Total investments	$ 27,558,570,000	$ 24,663,692,000

Short-term investments consist primarily of U.S. government treasury securities, high-grade commercial paper, and discounted notes. Bonds, notes, and other consist primarily of U.S. government agency and treasury securities, mortgage-backed securities, collateralized mortgage obligations, high-grade corporate securities, international corporate and government securities, and investments in domestic and international pooled funds. Equities consist primarily of U.S. and international stock, as well as private equity investment funds.

Investment income was comprised of the following for the years ended December 31, 2003 and 2002:

	2003	2002
Interest and dividend income	$ 1,057,132,000	$ 1,136,672,000
Net realized and unrealized gain on investments	2,992,191,000	939,075,000
Investment expenses:		
Contributed investment management expenses (see note 2(f))	(81,403,000)	(82,479,000)
Third party investment management and custodian fees and other expenses	(39,716,000)	(27,857,000)
Investment income, net	$ 3,928,204,000	$ 1,965,411,000

(5) Securities Lending

The Foundation participates in securities lending transactions with a third-party investment company whereby the Foundation lends certain investments in exchange for a premium. Under the terms of its securities lending agreement, the Foundation requires collateral of a value at least equal to 102% of the fair value of the loaned investments and accrued interest, if any. The Foundation maintains effective control of the loaned investments during the term of the agreement, in that they may be redeemed prior to the agreement's maturity. Upon the maturity of the agreement, the borrower must return the same, or substantially the same, investments that were borrowed. The risks to the Foundation of securities lending are that the borrower may not provide additional collateral when required or return the investments when due. However, the Foundation believes that its risk is low. Investments loaned under secured lending transactions totaled $5,061,514,000 and $6,074,988,000 as of December 31, 2003 and 2002, respectively.

Cash and noncash financial instruments received as collateral totaled $5,158,317,000 and $6,227,466,000 as of December 31, 2003 and 2002, respectively. Amounts received as collateral are included in investments and as a payable under investment loan agreements in the accompanying statements of financial position as of December 31, 2003 and 2002.

(6) Derivative Financial Instruments

In the normal course of business, the Foundation uses various financial instruments, including derivative financial instruments, in an effort to manage exposure on long-term investments.

Specifically, to manage price and interest rate risk associated with investing activities, the Foundation primarily uses a combination of forward contracts and futures. Under these instruments, the Foundation agrees to the future delivery of a currency or security, on an agreed-upon date, and at an agreed-upon price. These contracts are entered into with the intention to minimize the Foundation's economic exposure to adverse fluctuations in financial or currency markets and to reduce interest rate risk.

The Foundation also enters into derivative instruments for speculative and other purposes, including income enhancement and as an alternative to ownership of the underlying asset. Specifically, written options and forward contracts are sometimes used for enhancing returns on other investments and as an alternative to ownership, respectively.

All of the Foundation's derivative instrument positions are marked to current value as a change in net assets. The gross fair values of these instruments are included in investments in bonds and notes.

The notional and fair values of forward contracts, futures, and options as of December 31, 2003 and 2002 are as follows:

	2003		2002	
	Notional value	**Fair value**	**Notional value**	**Fair value**
Forward contracts	$ 3,933,775,214	$ 150,343,000	$ 1,717,856,000	$ 28,420,000
Futures	56,034,006,460	28,684,000	(20,968,371,000)	(12,959,000)
Options	(167,736,750)	6,237,000	5,004,000	4,543,000
Swaps	(157,433,016)	(1,740,000)	—	—
		$ 183,524,000		$ 20,004,000

All notional amounts have been translated to and aggregated in U.S. dollars.

The Foundation's derivative instruments involve varying degrees of risk of loss in excess of the amount recognized in the statement of financial position, arising either from potential changes in market prices or the possible inability of counterparties to meet the terms of their contracts. The Foundation's investment advisors monitor the financial condition of the firms used for these contracts in order to minimize the risk of loss. Management believes the Foundation's use of derivatives does not result in credit or market risk that would materially affect the Foundation's financial statements.

(7) Property and Equipment

At December 31, 2003 and 2002 property and equipment consist of the following:

	2003	2002
Work in progress	$ 65,000	$ —
Computers, printers, and software	17,321,000	16,587,000
Furniture and fixtures	5,823,000	5,278,000
Telecommunications	740,000	734,000
Leasehold improvements	20,334,000	18,691,000
	44,283,000	41,290,000
Less accumulated depreciation and amortization	(21,723,000)	(13,508,000)
Property and equipment, net	$ 22,560,000	$ 27,782,000

(8) Grants Payable

Grants payable totaling $1,845,554,000 and $1,900,035,000 at December 31, 2003 and 2002, respectively, consisted of approved grant commitments. As of December 31, 2003, such amounts are expected to be paid in the following years:

2004	$ 574,177,000
2005	565,374,000
2006	425,029,000
2007	206,627,000
2008	41,333,000
Thereafter	33,014,000
	1,845,554,000
Less discount to reflect grants payable at present value	(172,686,000)
Grants payable, net	$ 1,672,868,000

(9) Federal Excise Taxes

The Foundation is subject to federal excise taxes imposed on private foundations at 2%, or at 1% if certain conditions are met. The excise tax is imposed on net investment income, as defined under federal law, which includes realized gains on the sale of investments. The Foundation qualified for a 1% excise tax rate for the year ended December 31, 2003, and paid a 2% excise tax rate for the year ended December 31, 2002. The current portion of excise tax expense is $20,129,000 and $30,637,000 for the years ended December 31, 2003 and 2002, respectively.

The Foundation made provisions for deferred excise taxes in 2003 and 2002, which were recorded at the 1% excise tax rate in 2003 and in 2002. Deferred excise tax expense was $13,925,000 and $13,464,000 for the years ended December 31, 2003 and 2002, respectively, resulting from unrealized appreciation (gains) on investments.

(10) Retirement Plan

The Foundation has two retirement plans: 1) a 401(k) and 2) a Money Purchase Plan.

The 401(k) retirement plan covers employees meeting certain qualifications. Under the terms of the plan, employees are allowed to contribute up to 15% of their compensation subject to annual limitations.

The Money Purchase retirement plan covers employees meeting certain plan qualifications. Under the terms of the plan, the Foundation contributes 15% of employee-eligible plan compensation subject to annual limitations. Employees are immediately vested in employer contributions. For the years ended December 31, 2003 and 2002, employer contributions to the Money Purchase retirement plan totaled $2,443,000 and $2,154,000, respectively.

(11) Commitments and Contingencies

(a) Lease Commitments

The Foundation is obligated under various operating leases for equipment and office facilities which expire on various dates through 2011. Future minimum lease payments related to these leases as of December 31, 2003 are as follows:

2004	$	3,235,000
2005		3,323,000
2006		3,301,000
2007		3,016,000
2008		2,984,000
Thereafter		8,466,000
Total lease commitments	$	24,325,000

Rent expense totaled $5,215,000 and $3,373,000 for the years ended December 31, 2003 and 2002, respectively.

(b) Legal Matters

In the ordinary course of business, the Foundation is subject to certain legal actions. In the opinion of management, such matters will not have a material effect on the financial position of the Foundation.

(12) U.S. Library Program Wind Down

The Foundation's U.S. Library Program was created in order to partner with public libraries to bring access to computers, the Internet, and digital information for patrons in low-income communities throughout the United States. This program has been delivered through a combination of grants as well as direct charitable activities including training, deployment, and support. In 2002, the U.S. Library Program achieved certain milestones including the completion of the grant award portion of the program. These milestones have triggered the wind down phase, which was part of the original program design.

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The wind down phase was developed and communicated in 2002 and will result in the involuntary departure of approximately 112 employees. These departures began in December of 2002 and will continue through 2004, on a quarterly basis, as the program achieves the final milestones. Affected employees are eligible to receive one-time termination benefits once they have completed specific service requirements that are timed with the completion of program milestones.

Management estimates that the total cost of these termination benefits payable over the wind down period will be $4,217,000. Of this total cost, $2,685,000 and $1,177,000 was recorded in 2003 and 2002, respectively. These amounts have been reflected as a direct charitable expense on the statement of activities for the periods then ended. The liability (benefit costs less benefit payments made) as of December 31, 2003 is $1,683,999 and is reflected as accrued and other liabilities on the accompanying statement of financial position. The following table shows the activity for the liability (included in accrued and other liabilities) as of December 31, 2003 and 2002:

	2003	2002
Beginning liability balance	$ 1,172,000	$ —
Benefits incurred and charged to expense	2,685,000	1,177,000
Benefits paid	(2,174,000)	(5,000)
Ending liability balance	$ 1,683,000	$ 1,172,000