



**BILL & MELINDA GATES FOUNDATION**

Financial Statements

December 31, 2005 and 2004

(With Independent Auditors' Report Thereon)



**KPMG LLP**  
Suite 900  
801 Second Avenue  
Seattle, WA 98104

## **Independent Auditors' Report**

The Trustees  
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, 2005 and 2004, 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Foundation's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, 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, 2005 and 2004, and the changes in its net assets and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

**KPMG LLP**

March 24, 2006

**BILL & MELINDA GATES FOUNDATION**

Statements of Financial Position

December 31, 2005 and 2004

(In thousands)

<b>Assets</b>	<b>2005</b>	<b>2004</b>
Cash and cash equivalents	\$ 182,820	\$ 186,118
Investments	29,466,691	29,433,534
Investments loaned under secured lending transactions	4,340,182	5,521,622
Investment sales receivable	712,669	672,347
Interest and dividends receivable	223,053	278,714
Federal excise tax refunds receivable	1,707	2,850
Program related investments receivable	720	1,440
Property and equipment, net	25,539	18,959
Total assets	<u>\$ 34,953,381</u>	<u>\$ 36,115,584</u>
<b>Liabilities and Net Assets</b>		
Liabilities:		
Accounts payable	\$ 13,442	\$ 5,736
Payable under investment loan agreements	4,444,308	5,637,866
Investment purchases payable	1,355,565	1,679,111
Accrued and other liabilities	10,077	19,481
Deferred excise taxes payable	26,832	34,039
Grants payable, net	2,096,441	1,885,062
Total liabilities	7,946,665	9,261,295
Net assets – unrestricted	<u>27,006,716</u>	<u>26,854,289</u>
Total liabilities and net assets	<u>\$ 34,953,381</u>	<u>\$ 36,115,584</u>

See accompanying notes to financial statements.

**BILL & MELINDA GATES FOUNDATION**

Statements of Activities

Years ended December 31, 2005 and 2004

(In thousands)

	<u>2005</u>	<u>2004</u>
Change in net assets:		
Revenues and gains:		
Contributions	\$ 442,701	\$ 711,453
Investment income, net	1,421,334	2,632,002
Total revenues and gains	<u>1,864,035</u>	<u>3,343,455</u>
Expenses:		
Grants	1,566,809	1,464,573
Direct charitable expenses	37,921	25,297
Program and administrative expenses	92,042	68,303
Federal excise tax	14,836	22,300
Total expenses	<u>1,711,608</u>	<u>1,580,473</u>
Changes in net assets	152,427	1,762,982
Unrestricted net assets, beginning of year	<u>26,854,289</u>	<u>25,091,307</u>
Unrestricted net assets, end of year	<u>\$ 27,006,716</u>	<u>\$ 26,854,289</u>

See accompanying notes to financial statements.

**BILL & MELINDA GATES FOUNDATION**

Statements of Cash Flows

Years ended December 31, 2005 and 2004

(In thousands)

	<u>2005</u>	<u>2004</u>
Cash flows from operating activities:		
Change in net assets	\$ 152,427	\$ 1,762,982
Adjustments to reconcile change in net assets to net cash (used in) provided by operating activities:		
Depreciation and amortization	6,627	9,442
Net realized and unrealized gains on sale of investments	(545,675)	(1,746,010)
Changes in operating assets and liabilities:		
Investment sales receivable	(40,322)	6,873
Interest and dividends receivable	55,661	22,167
Federal excise tax refunds receivable	1,143	10,095
Program related investment receivable	720	—
Accounts payable	7,706	1,010
Investment purchases payable	(323,547)	(30,571)
Accrued and other liabilities	(9,404)	3,898
Deferred excise taxes	(7,207)	8,005
Grants payable, net	211,379	212,194
Net cash (used in) provided by operating activities	<u>(490,492)</u>	<u>260,085</u>
Cash flows from investing activities:		
Purchases of investments	(250,726,826)	(187,752,068)
Proceeds from sales of investments	251,239,344	187,623,114
Cash (paid) received under secured lending arrangements	(12,118)	19,441
Purchases of property and equipment	(13,206)	(5,841)
Net cash provided by (used in) investing activities	<u>487,194</u>	<u>(115,354)</u>
Net (decrease) increase in cash and cash equivalents	(3,298)	144,731
Cash and cash equivalents, beginning of year	<u>186,118</u>	<u>41,387</u>
Cash and cash equivalents, end of year	<u>\$ 182,820</u>	<u>\$ 186,118</u>
Supplemental disclosure of cash flow information:		
Cash paid during the year for excise taxes	\$ 20,900	\$ 4,200
Noncash contributions	122,701	84,453

See accompanying notes to financial statements.

## BILL & MELINDA GATES FOUNDATION

Notes to Financial Statements

December 31, 2005 and 2004

(In thousands)

### (1) Organization

The Bill & Melinda Gates Foundation (the Foundation) is a tax-exempt private foundation that works to reduce inequities around the world. In the developing world, it focuses on improving health, increasing free public access to digital information, and alleviating extreme poverty. In the United States, the Foundation supports programs related to education and free public access to information. In its local region, the Foundation promotes strategies and programs that help low-income 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, 2005 and 2004, 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*

Investment 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. As there is no ready market for private equities, they are stated at fair value as estimated by the general partner. The Foundation reviews and evaluates the values provided by the general partner and agrees with the valuation methods and assumptions used in determining the fair value of private equity investments. Private equity investments make up less than 3% of total investments. 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.

**BILL & MELINDA GATES FOUNDATION**

Notes to Financial Statements

December 31, 2005 and 2004

(In thousands)

**(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	5 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, 2005 and 2004, grants payable were discounted using rates ranging from 3.25% to 5.5%.

**(f) *Contributed Services***

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 provided by a related party, totaled \$122,701 and \$84,453 for the years ended December 31, 2005 and 2004, respectively. Investment management services contributed are reflected as contributions revenue, and as investment management services expense which is netted against investment income. All other types of contributed services are reflected in program and administration 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) *Presentation of Expenses on the Statement of Activities***

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.

**BILL & MELINDA GATES FOUNDATION**

Notes to Financial Statements

December 31, 2005 and 2004

(In thousands)

*(i) 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.

**(3) Functional Allocation of Expenses**

At December 31, 2005 and 2004, the Foundation's financial allocation of expenses is represented as follows:

	<u>2005</u>	<u>2004</u>
Program expenses:		
Health programs	\$ 1,000,492	\$ 642,345
Education programs	351,927	767,908
Library programs	29,284	28,989
Strategic opportunities	224,927	28,511
Pacific Northwest, advocacy and other programs	47,725	54,031
Total program expenses	<u>1,654,355</u>	<u>1,521,784</u>
Management and general expenses	42,417	36,389
Federal excise tax expense	14,836	22,300
Total expenses	<u>\$ 1,711,608</u>	<u>\$ 1,580,473</u>

**(4) Investments**

At December 31, 2005 and 2004, the Foundation's investments consist of the following:

	<u>2005</u>	<u>2004</u>
Short-term investments	\$ 4,548,609	\$ 7,143,262
Bonds, notes, and other	19,799,435	20,394,702
Equities	9,458,829	7,417,192
	<u>33,806,873</u>	<u>34,955,156</u>
Less investments loaned under secured lending transactions	<u>(4,340,182)</u>	<u>(5,521,622)</u>
Total investments	<u>\$ 29,466,691</u>	<u>\$ 29,433,534</u>

## BILL & MELINDA GATES FOUNDATION

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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, 2005 and 2004:

	<u>2005</u>	<u>2004</u>
Interest and dividend income	\$ 1,017,165	\$ 1,026,077
Net realized and unrealized gains on investments	545,675	1,746,010
Investment expenses:		
Contributed investment management expenses (see note 2(f))	(122,035)	(83,677)
Third party investment management and custodian fees and other expenses	(19,471)	(56,408)
Investment income, net	<u>\$ 1,421,334</u>	<u>\$ 2,632,002</u>

### (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 principal risks to the Foundation of securities lending are that the yield earned on the collateral is insufficient to cover the rebate owed to the borrower, and that an investment purchased via the collateral reinvestment process becomes impaired. However, the Foundation believes that its risk is low. Investments loaned under secured lending transactions totaled \$4,340,182 and \$5,521,622 as of December 31, 2005 and 2004, respectively.

Cash and noncash financial instruments received as collateral totaled \$4,444,308 and \$5,637,866 as of December 31, 2005 and 2004, 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, 2005 and 2004.

### (6) Derivative Financial Instruments

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

## BILL & MELINDA GATES FOUNDATION

Notes to Financial Statements

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(In thousands)

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 component of investment income. The gross fair values of these instruments are included in investments in bonds, notes, and other.

The notional and fair values of forward contracts, futures, options, and swaps as of December 31, 2005 and 2004 are as follows:

	2005		2004	
	<u>Notional value</u>	<u>Fair value</u>	<u>Notional value</u>	<u>Fair value</u>
Forward contracts	\$ 7,681,376	\$ 33,868	\$ 6,898,718	\$ (8,785)
Futures	90,784,348	(3,147,391)	53,117,447	(7,145)
Options	97,248	(110)	(60,002)	2,013
Swaps	(1,498,577)	(15,806)	(948,920)	(16,180)
		<u>\$ (3,129,439)</u>		<u>\$ (30,097)</u>

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.

**BILL & MELINDA GATES FOUNDATION**

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(In thousands)

**(7) Property and Equipment**

At December 31, 2005 and 2004, property and equipment consist of the following:

	<u>2005</u>	<u>2004</u>
Construction in progress	\$ 13,413	\$ 337
Computers, printers, and software	19,698	19,394
Furniture and fixtures	6,658	6,487
Telecommunications	764	764
Leasehold improvements	22,396	22,740
	<u>62,929</u>	<u>49,722</u>
Less accumulated depreciation and amortization	<u>(37,390)</u>	<u>(30,763)</u>
Property and equipment, net	<u>\$ 25,539</u>	<u>\$ 18,959</u>

**(8) Grants Payable**

Grants payable totaling \$2,344,966 and \$2,112,335 (discounted to \$2,096,441 and \$1,885,062) at December 31, 2005 and 2004, respectively, consisted of approved grant commitments. As of December 31, 2005, such amounts are expected to be paid in the following years:

2006	\$ 768,689
2007	516,468
2008	312,170
2009	241,052
2010	164,362
Thereafter	<u>342,225</u>
	2,344,966
Less discount to reflect grants payable at present value	<u>(248,525)</u>
Grants payable, net	<u>\$ 2,096,441</u>

**(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 years ended December 31, 2005 and 2004. The current portion of excise tax expense is \$22,043 and \$14,294 for the years ended December 31, 2005 and 2004, respectively.

## BILL & MELINDA GATES FOUNDATION

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(In thousands)

The Foundation made provisions for deferred excise taxes in 2005 and 2004, which were recorded at the 1% excise tax rate in 2005 and 2004. Deferred excise tax expense (credit) was \$(7,207) and \$8,006 for the years ended December 31, 2005 and 2004, respectively, resulting from unrealized gains on investments.

### (10) Retirement Plan

The Foundation has two retirement plans: a 401(k) Plan and 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, 2005 and 2004, employer contributions to the Money Purchase retirement plan totaled \$3,185 and \$2,568, 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, 2005 are as follows:

2006	\$	5,090
2007		5,663
2008		5,823
2009		5,709
2010		5,839
Thereafter		<u>9,608</u>
Total lease commitments	\$	<u><u>37,732</u></u>

Rent expense totaled \$3,584 and \$4,232 for the years ended December 31, 2005 and 2004, 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.