

FINANCIAL STATEMENTS

John S. and James L. Knight Foundation
Years Ended December 31, 2004 and 2003

John S. and James L. Knight Foundation

Financial Statements

Years Ended December 31, 2004 and 2003

Contents

Report of Independent Certified Public Accountants	1
Audited Financial Statements	
Statements of Financial Position.....	2
Statements of Activities	3
Statements of Cash Flows	4
Notes to Financial Statements.....	5

Report of Independent Certified Public Accountants

The Trustees
John S. and James L. Knight Foundation

We have audited the accompanying statements of financial position of the John S. and James L. Knight Foundation (the Foundation) as of December 31, 2004 and 2003, 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. 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, and 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 at December 31, 2004 and 2003, and its changes in unrestricted net assets and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States.

Ernst + Young LLP

February 23, 2005

John S. and James L. Knight Foundation

Statements of Financial Position

	December 31	
	2004	2003
Assets		
Investments		
Cash and cash equivalents	\$ 48,469,939	\$ 162,687,829
Interest, dividends and other investment receivables	8,001,590	5,094,509
U.S. government and agency obligations	324,285,899	252,770,682
Corporate bonds and other obligations	82,687,544	85,427,021
Common stock of Knight Ridder	33,470,000	59,975,831
Other equity securities	1,054,787,077	911,552,289
Alternative equity investments	280,746,140	263,166,541
Real estate investments	106,182,294	104,391,562
Total investments	<u>1,938,630,483</u>	1,845,066,264
Other assets	710,422	802,784
Total assets	<u>\$ 1,939,340,905</u>	<u>\$ 1,845,869,048</u>
Liabilities and unrestricted net assets		
Grants payable	\$ 120,746,757	\$ 110,212,152
Other liabilities	1,374,756	558,289
Total liabilities	<u>122,121,513</u>	110,770,441
Unrestricted net assets	1,817,219,392	1,735,098,607
Total liabilities and unrestricted net assets	<u>\$ 1,939,340,905</u>	<u>\$ 1,845,869,048</u>

See accompanying notes.

John S. and James L. Knight Foundation

Statements of Activities

	Years Ended December 31	
	2004	2003
Investment activity:		
Interest	\$ 18,425,835	\$ 26,094,091
Dividends	11,513,841	13,268,775
Net realized gain on sale of investments	193,112,318	50,314,176
Net change in fair value of investments	(23,830,170)	143,039,539
Less: investment expenses	(5,149,017)	(6,069,448)
Total investment activity	<u>194,072,807</u>	226,647,133
Contributions received	<u>21,706</u>	198,168
Total investment activity and other support	<u>194,094,513</u>	226,845,301
Grants approved and expenses:		
Community Partners grants	61,135,880	79,754,840
Journalism Initiative grants	14,823,500	39,115,430
National Venture Fund grants	22,315,500	925,400
Other grants	1,630,600	595,200
Grant forfeitures and other	(2,928,238)	(3,853,728)
Direct charitable activities	3,634,867	4,058,149
General and administrative expenses	9,582,761	10,135,667
Federal excise and other taxes, net	1,778,858	(435,864)
Total grants and expenses	<u>111,973,728</u>	138,623,694
Change in unrestricted net assets	82,120,785	88,221,607
Unrestricted net assets at beginning of year	<u>1,735,098,607</u>	1,646,877,000
Unrestricted net assets at end of year	<u>\$1,817,219,392</u>	<u>\$1,735,098,607</u>

See accompanying notes.

John S. and James L. Knight Foundation

Statements of Cash Flows

	Years Ended December 31	
	2004	2003
Operating activities		
Change in unrestricted net assets	\$ 82,120,785	\$ 88,221,607
Adjustments to reconcile change in unrestricted net assets to net cash used in operating activities:		
Net realized gain on sale of investments	(193,112,318)	(50,314,176)
Net change in fair value of investments	23,830,170	(143,039,539)
Changes in operating assets and liabilities:		
Interest, dividends and other investment receivables	(2,907,081)	50,971
Other assets	92,362	316,710
Grants payable	10,534,605	39,127,581
Other liabilities	816,467	283,622
Net cash used in operating activities	<u>(78,625,010)</u>	<u>(65,353,224)</u>
Investing activities		
Proceeds from sale of investments	1,206,308,398	1,325,401,706
Purchases of investments	<u>(1,241,901,278)</u>	<u>(1,171,772,416)</u>
Net cash (used in) provided by investing activities	(35,592,880)	153,629,290
Net change in cash and cash equivalents	(114,217,890)	88,276,066
Cash and cash equivalents at beginning of year	162,687,829	74,411,763
Cash and cash equivalents at end of year	<u>\$ 48,469,939</u>	<u>\$ 162,687,829</u>

See accompanying notes.

John S. and James L. Knight Foundation

Notes to Financial Statements

December 31, 2004

1. The Organization

The John S. and James L. Knight Foundation (the Foundation), a nonprofit corporation, promotes excellence in journalism worldwide and invests in the vitality of 26 U.S. communities.

2. Significant Accounting Policies

Cash and Cash Equivalents

Cash and cash equivalents are composed of various operating accounts and highly liquid investments with original maturities of 90 days or less.

Property, Plant and Equipment

The Foundation records property, plant and equipment as an expense in the year purchased. Property, plant and equipment purchased for 2004 and 2003 was approximately \$260,000 and \$1,900,000, respectively, of which approximately \$194,000 and \$1,454,000 were for charitable purposes and are reflected in "General and administrative expenses" in the Statements of Activities.

Program-Related Investments (PRIs)

In accordance with Section 4944 of the Internal Revenue Code (the code), the Foundation is permitted to make investments that are related to its philanthropic programs. These investments are anticipated to have a return lower than fair value. In the year of the investment, the Foundation receives a credit toward its distribution requirement. These investments are treated as grants in the year they are approved. To the extent the investment is recovered by the Foundation, the recovery is recognized as a negative distribution. Recoveries are reflected in "Grant forfeitures and other" in the Statements of Activities.

Use of Estimates

The presentation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amounts of investment activity and expenses during the reporting period. Actual results could differ from those estimates.

John S. and James L. Knight Foundation

Notes to Financial Statements (continued)

2. Significant Accounting Policies (continued)

Reclassification

Certain amounts in the prior year's financial statements have been reclassified to conform with the current year's presentation.

3. Investments

The investment goal of the Foundation is to invest its assets in a manner that will achieve a total rate of return sufficient to replace the assets spent for grants and expenses and to recoup any value lost due to inflation. To achieve this goal, some investment risk must be taken. To minimize such risk, the Foundation diversifies its investments among various financial instruments and asset categories, and uses multiple investment strategies and investment managers. Key decisions in this regard are made by the Foundation's investment committee, which has oversight responsibility for the Foundation's investment program. The committee identifies appropriate asset categories for investments, determines the allocation of assets to each category and approves the investment strategies employed. The Foundation's chief investment officer is responsible for the effective execution of the investment program, including the engagement of investment managers, financial consultants and legal advisers, as required. The majority of the Foundation's financial assets are managed by external investment management firms selected by the chief investment officer. The Foundation's holdings in Knight Ridder common stock, Treasury Inflation Protected Securities (TIPS), commodities, derivative overlays, equities distributed by its limited partnership investments and strategic allocations to index funds are managed by the Foundation's investment department. All financial assets are held in custody for the Foundation in proprietary accounts by a major commercial bank, except those assets that have been invested in limited partnerships, hedge funds or in certain products with multiple investors, such as index funds, all of which have separate custodial arrangements appropriate to their legal structure.

Effective March 1, 2005, Cambridge Associates, LLC (Cambridge), an independent consulting firm, will assume all discretionary investment authority formerly residing with the chief investment officer, and will also assume all functions and responsibilities of the internal investment department. As a result, the Foundation will disband its internal investment department, with the exception of staff to monitor and support the related internal controls and accounting for investments. The Foundation's investment committee will retain its oversight responsibility for the Foundation's investment program.

John S. and James L. Knight Foundation

Notes to Financial Statements (continued)

3. Investments (continued)

The majority of the Foundation's financial assets are invested in publicly traded securities that are listed on national exchanges, treasury and agency bonds of the U.S. government, sovereign bonds of foreign governments and investment and non-investment grade corporate bonds for which active trading markets exist. Such assets are valued at quoted closing prices at year end. Realized gains and losses and increases and decreases in fair value on investments are reflected in the Statements of Activities.

At December 31, 2004 and 2003, approximately 20 percent of the Foundation's assets were invested with numerous partnerships, in which the Foundation is a limited partner, that specialize in making venture capital, buyout, distressed debt, and equity-based real estate investments. Such investments, typically investments in private equity or debt securities of companies or properties that are not publicly listed or traded, are not liquid investments. The value of such investments is determined by the partnerships' general partners, who must follow the valuation guidelines, such as appraisals and comparable company trade data, stipulated in the respective limited partnership agreements. The December 31 valuations of the investments in limited partnerships are based upon the value determined by the partnerships' general partner as of September 30, adjusted for capital contributions and distributions that occur during the quarter ended December 31. These amounts may differ from values that would be determined if the investments in limited partnerships were publicly traded or if the December 31 valuation amount were currently available. Realized gains and losses and increases and decreases in fair value on the investments in limited partnerships are reflected in the Statements of Activities. All limited partnerships are audited annually by independent certified public accounting firms. As of December 31, 2004, pursuant to its limited partnership agreements, the Foundation is committed to contributing approximately \$295,200,000 in additional capital over the next 10 years to various partnerships. Unpaid commitments at December 31, 2003, were approximately \$242,900,000.

At December 31, 2004 and 2003, the Foundation held 500,000 and 775,182 shares, respectively, of Knight Ridder common stock, which represented 2 percent and 3 percent of the Foundation's assets, respectively.

John S. and James L. Knight Foundation

Notes to Financial Statements (continued)

3. Investments (continued)

A detail of fair value and cost by investment class follows:

	December 31, 2004		December 31, 2003	
	Fair Value	Cost	Fair Value	Cost
Cash and cash equivalents	\$ 48,469,939	\$ 48,469,939	\$ 162,687,829	\$ 162,687,829
Interest, dividends and other investment receivables	8,001,590	7,868,897	5,094,509	4,603,757
U.S. government and agency obligations	324,285,899	309,844,407	252,770,682	233,436,179
Corporate bonds and other obligations	82,687,544	81,150,921	85,427,021	82,411,615
Common stock of Knight Ridder	33,470,000	13,937,500	59,975,831	21,608,198
Other equity securities	1,054,787,077	825,571,698	911,552,289	693,776,149
Alternative equity investments	280,746,140	406,755,703	263,166,541	380,802,663
Real estate investments	106,182,294	92,320,753	104,391,562	90,042,671
Total	<u>\$ 1,938,630,483</u>	<u>\$ 1,785,919,818</u>	<u>\$ 1,845,066,264</u>	<u>\$ 1,669,369,061</u>

Highly liquid investments with original maturities of three months or less are reported as cash equivalents.

4. Derivative Financial Instruments

Some investment managers retained by the Foundation have been authorized to use certain derivative financial instruments in a manner set forth by the Foundation's written investment policy, specific manager guidelines or partnership/fund agreement documents. Specifically, derivative financial instruments may be used for the following purposes: (1) currency forward contracts and options may be used to hedge nondollar exposure in foreign investments; (2) covered call options may be sold to enhance yield on major equity positions; (3) futures contracts may be used to equitize excess cash positions, rebalance asset categories within the portfolio, adjust risk exposures within the portfolio, or to rapidly increase or decrease exposure to specific investment positions in anticipation of subsequent cash trades; and (4) futures contracts and options may be used by hedge fund managers to hedge or leverage positions in portfolios in their respective funds. Authorization to use derivatives currently is restricted to 22 hedge fund managers, who manage investments totaling approximately \$549,000,000 and one currency overlay manager, who at December 31, 2004 did not have any buy or sell positions.

John S. and James L. Knight Foundation

Notes to Financial Statements (continued)

4. Derivative Financial Instruments (continued)

The Foundation's chief investment officer also is authorized to use derivatives to execute certain investment strategies. Derivative financial instruments are recorded at fair value in the Statements of Financial Position with changes in fair value reflected in the Statements of Activities.

At December 31, 2004, the Foundation had no currency forward contracts. At December 31, 2003, the Foundation had a currency forward contract valued at \$32,135,000 with one correspondent bank. This represents a hedge against a portion of the Foundation's Euro-denominated capital commitments to its limited partnerships valued at \$44,700,000. All currency forward contracts are up to six months in duration and are typically renewed. At December 31, 2003, the fair value of this currency forward contract, which is reflected in the Statements of Financial Position, was approximately \$447,000.

During 2004 and 2003, the Foundation entered into various futures contracts. At December 31, 2004, the Foundation had opened positions with various futures contracts with a net aggregate notional value of approximately \$120,571,000. At December 31, 2003, the Foundation had opened positions with various future contracts with a net aggregate notional value of approximately \$146,500,000. The futures contracts selected are exchange-listed, highly liquid contracts providing daily settlements. Gains and losses were processed daily through the NYSE third-party clearing broker and settled within an account at the Foundation's custodian bank. For the years ended December 31, 2004 and 2003, net realized gains and (losses) from futures contracts totaled approximately \$9,654,000 and (\$6,100,000), respectively, and are reflected in the Statements of Activities.

In the opinion of the Foundation's management, the use of derivative financial instruments in its investment program is appropriate and customary for the investment strategies employed. Using those instruments reduces certain investment risks and generally adds value to the portfolio. The instruments themselves, however, do involve some investment and counter party risk not fully reflected in the Foundation's financial statements. Management does not anticipate that losses, if any, from such instruments would materially affect the financial position of the Foundation.

John S. and James L. Knight Foundation

Notes to Financial Statements (continued)

5. Grants

The Foundation records grants in full as expenses when approved. Grants payable at December 31, 2004 and 2003 represents the present value of multiyear grants using a 5.25 percent and 4.00 percent discount rate, respectively. The Foundation made grant payments of \$90,358,608 and \$90,400,477 in 2004 and 2003, respectively.

As of December 31, 2004, the Foundation had future grant commitments, which are scheduled for payment in future years as follows:

2005	\$ 73,291,527
2006	41,448,142
2007	10,928,160
2008	5,303,330
	<hr/>
	130,971,159
Discounted to present value	(10,224,402)
Grants payable	<hr/> <hr/>
	\$ 120,746,757

6. Federal Excise Taxes

The Foundation qualifies as a tax-exempt organization under Section 501(c)(3) of the code and, with the exception of unrelated business income from debt-financed, passive investments, is not subject to federal or state income tax. However, the Foundation is classified as a private Foundation and is subject to a federal excise tax of 2 percent (or 1 percent under certain circumstances) on net investment income and net realized gains, as defined by the code. The Foundation expects to qualify for the 1 percent tax rate in 2004 and was subject to the 1 percent tax rate in 2003.

Total excise and other taxes paid by the Foundation for the year ended December 31, 2004, amounted to approximately \$1,450,000. For the year ended December 31, 2003 the Foundation received a net refund of approximately \$970,000 in excise and other taxes.

John S. and James L. Knight Foundation

Notes to Financial Statements (continued)

7. Employee Pension Plan and Other Postretirement Benefit Plans

The Foundation sponsors a pension plan with defined benefit and cash balance features for its eligible employees. The pension benefits for all employees hired prior to January 1, 2000, will be the greater of the benefits as determined under the defined benefit feature of the pension plan or the cash balance feature of the pension plan. The pension benefits for all employees hired on or subsequent to January 1, 2000, will be determined under the cash balance feature of the pension plan. The Foundation also sponsors postretirement medical and life insurance benefit plans.

The following table sets forth the pension and other postretirement benefits plans' funded status and amounts recognized in the Foundation's Statements of Financial Position:

	Pension Plan		Other Postretirement Benefit Plans	
	Year Ended December 31		Year Ended December 31	
	2004	2003	2004	2003
Fair value of plan assets	\$ 7,678,257	\$ 6,577,343	\$ 411,258	\$ 225,840
Benefit obligation	(8,631,636)	(6,834,540)	(1,600,035)	(1,583,763)
Funded status of the plan	\$ (953,379)	\$ (257,197)	\$ (1,188,777)	\$ (1,357,923)
Accrued benefit asset/(liability) recognized in the Statements of Financial Position	\$ 710,422	\$ 802,784	\$ (589,533)	\$ (519,370)
Service cost	686,186	550,030	80,890	61,121
Interest cost	426,723	385,098	83,819	86,565
Expected return on plan assets	(519,638)	(504,281)	(23,306)	(10,789)
Amortization of prior service cost	45,675	45,675	84,973	84,973
Amortization of transition asset	(9,811)	(9,812)	-	-
Recognized actuarial loss	13,227	-	14,616	19,431
Benefit cost recognized in the Statements of Activities	642,362	466,710	240,992	241,301
Employer contributions	550,000	150,000	170,807	265,611
Employee contributions	-	-	977	1,196
Benefits paid	198,105	306,256	27,723	44,940

John S. and James L. Knight Foundation

Notes to Financial Statements (continued)

7. Employee Pension Plan and Other Postretirement Benefit Plans (continued)

	Pension Plan		Other Postretirement Benefit Plans	
	Year Ended December 31		Year Ended December 31	
	2004	2003	2004	2003
Actuarial assumptions				
Discount rate	5.75%	6.25%	5.75%	6.25%
Expected return on plan assets	8.00	8.00	8.00	8.00
Rate of compensation increase	4.50	3.75	4.50	3.75
Health care cost trend rate assumptions				
Initial trend rate	N/A	N/A	14.00%	15.00%
Ultimate trend rate	N/A	N/A	5.25	5.25
Year ultimate trend is reached	N/A	N/A	2014	2014

The expected long-term rate of return on plan assets for determining net periodic pension cost is chosen by the Foundation from a best estimate range determined by the actuary by applying anticipated long-term returns and long-term volatility for various asset categories to the target asset allocation of the plan.

Expected benefit payments are as follows:

	Pension Plan		Other Postretirement Benefit Plans	
2005	\$	752,692	\$	50,730
2006		574,492		50,122
2007		366,410		54,570
2008		476,538		63,562
2009		827,807		72,117
2010-2014		3,534,052		557,469

During 2005, the Foundation is not required to make any contributions to the pension plan and is expected to contribute \$120,418 to the other postretirement benefit plans. If an unfunded accumulated benefit obligation exists at year-end the Foundation may wish to make a contribution in order to eliminate it.

John S. and James L. Knight Foundation

Notes to Financial Statements (continued)

7. Employee Pension Plan and Other Postretirement Benefit Plans (continued)

The investment goal for plan assets is to provide sufficient liquidity to meet payout requirements while maintaining safety of principal through prudent diversification. During 2004, asset allocation targets for the pension plan were large-cap domestic equity, 40 percent, small-cap domestic equity, 10 percent, international equity, 20 percent, domestic fixed income, 20 percent, and TIPS, 10 percent. During 2004, asset allocation targets for the other postretirement benefit plans were large-cap domestic equity, 65 percent, small-cap domestic equity, 10 percent, international equity, 10 percent, domestic fixed income, 10 percent, and domestic high yield, 5 percent.

A detail of fair value of plan assets by investment class follows:

	Pension Plan		Other Postretirement Benefit Plans	
	December 31		December 31	
	2004	2003	2004	2003
Cash and cash equivalents	\$ 621,189	\$ 369,192	\$ 7,010	\$ 12,677
Interest, dividends and other investment receivables	31,731	26,536	9	911
U.S. government and agency obligations	1,399,140	1,126,024	–	38,663
Corporate bonds and other obligations	534,734	572,417	57,577	19,655
Equity securities	5,091,463	4,483,174	346,662	153,934
Total	\$ 7,678,257	\$ 6,577,343	\$ 411,258	\$ 225,840

In addition, the Foundation sponsors a defined contribution plan for its eligible employees for which it has no fixed liabilities. Effective January 1, 2002, the Foundation's defined contribution plan was amended to add an employer matching contribution component. During 2004 and 2003, the Foundation made contributions to the defined contribution plan of approximately \$159,000 and \$149,000, respectively.

John S. and James L. Knight Foundation

Notes to Financial Statements (continued)

8. Leases

The Foundation has a lease for approximately 21,300 square feet of office space in Miami, Florida, which expires in 2013. The Foundation also has various leases for equipment, which expire between 2004 and 2005. Rental expense for office and equipment leases for 2004 and 2003 was approximately \$799,000 and \$924,000, respectively. Future minimum lease payments for office and equipment leases are as follows:

2005	\$ 680,999
2006	689,102
2007	705,066
2008	721,029
2009	736,993
Thereafter	<u>2,766,163</u>
Total	<u>\$ 6,299,352</u>