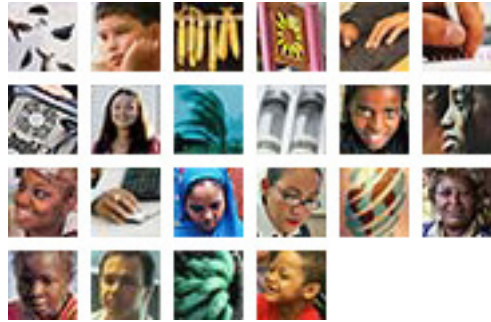


THE FACE
OF CHANGE
22 STORIES
FROM 2005



IN 2005, THE BILL & MELINDA GATES FOUNDATION HELPED OUR PARTNERS IMPROVE THE LIVES OF PEOPLE AROUND THE WORLD. LEARN ABOUT WHAT OUR PARTNERS ACCOMPLISHED, FROM FIGHTING DISEASES IN AFRICA AND REDESIGNING HIGH SCHOOLS IN THE UNITED STATES TO WIRING LIBRARIES IN MEXICO AND MATCHING AT-RISK GIRLS WITH MENTORS IN SEATTLE.

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LETTER FROM CEO

A Message From Patty Stonesifer

In 2005, there were more news stories than ever on the issues we care about: reforming U.S. high schools, closing the digital divide, helping vulnerable families in and around Washington state, reducing extreme poverty, and saving lives by improving health in poor countries. Many of these stories praised us and our grantees, but some of them raised important questions about our strategies. Questions like: Given our focus on preventing disease, are we doing enough to help people who are already sick? And, Does our Education program have the right approach for improving U.S. high schools?

These are good questions—and we’re going to try to answer them.

As an organization, we will help people know not just what we do, but why we’re doing it, how we’re working, and what we’re learning. This is one of the foundation’s top goals for the coming year.

Why does it matter? Because to solve the problems we’re all tackling, governments, non-governmental organizations, other foundations, and private industry need to work together. We’ve worked hard to help make that happen. But as we collaborate with public and private funders on a large scale, our partners, grantees, co-funders, and the public should know more. They should understand our values and the role we want to play in improving people’s lives. They should know what we’re learning from our grantmaking: what is working, and what isn’t. And they should understand the impact we want our grantmaking to have and know whether it’s actually making that impact.

I hope you’ll find this year’s annual report one step in the right direction. This year we’ve tried to be direct about what went well, what didn’t, and what we learned. Included in this report is my first Management Discussion and Analysis, which covers some questions I’m often asked about the foundation’s governance, finances, and other areas.

We’ll also continue or expand some of the things we’re already doing to publish information about our work. For instance, we post information about each of our grants in a searchable database on our Web site. Many of our programs have published evaluations of their work and made them available on the Web. And because it’s important to keep our own community up to date on our plans, we’ve devoted a section of our site to the new campus we’re building in Seattle. That campus will include a visitors learning center, which will be open to the public so they can learn more about our issues and how we work.

We’re still in the early stages of this effort, and we will have more to say on the subject through our Web site and in next year’s annual report. In the meantime, every one of us at the foundation is looking forward to making more progress on the issues we care about. And we’re looking forward to sharing the results—whether it’s good news or bad—with our partners and the public.

Patty Stonesifer



Patty Stonesifer (right) visits an AIDS and tuberculosis hospice in Botswana.

“As an organization, we will help people know not just what we do, but why we’re doing it, how we’re working, and what we’re learning.”

OVERVIEW

In 2005, the Bill & Melinda Gates Foundation helped our partners improve the lives of people around the world. Learn about what our partners accomplished, from fighting diseases in Africa and redesigning high schools in the United States to wiring libraries in Mexico and matching at-risk girls with mentors in Seattle.



EDUCATION

Ensuring that all students in the United States graduate from high school ready for college, work, and citizenship



GLOBAL HEALTH

Saving lives by fighting neglected diseases



GLOBAL LIBRARIES

Supporting free Internet access at public libraries in the United States and other countries



PACIFIC NORTHWEST

Helping at-risk families in our region improve their lives



OTHER INITIATIVES

Seizing opportunities to learn and have a great impact

OVERVIEW

Right now, America's high schools don't prepare most young people to face the challenges of today's economy. A third of the students who start high school don't graduate on time, and only half of those who do graduate have the skills that colleges and employers expect them to have. For African-American and Hispanic students, the statistics are even worse. Half won't graduate, and only half of those who do have the skills they need. Our goal is to ensure that every student in the United States graduates from high school ready for college, work, and citizenship.

We work with partners, including schools, school districts, states, and a variety of education organizations, to redesign high schools, school systems, and education policies to help all schools achieve their mission of teaching all the nation's children what they need to know. Education experts and experience tell us what works for young people: "the new 3 R's"—a rigorous curriculum, relevant classes, and meaningful relationships with adults who push students to achieve. These new 3 R's are the building blocks of successful high schools, and we look for ways to make them a part of students' everyday experiences.

In 2005, we worked extensively with governors and other state leaders, and state governments made significant progress in demanding rigor in their high schools. In February, the National Governors' Association held the National Education Summit on High Schools, at which Bill Gates gave a keynote address. In his speech he called U.S. high schools "obsolete" and encouraged governors to demonstrate their commitment to meeting the challenge facing our nation. The speech made headlines, and governors led the charge to develop state policies to improve their schools. Following the summit, more than half the states took concrete steps to increase graduation rates and set higher graduation standards. By making good education policy, states are raising the bar for all their high schools.

We also received evaluations of the schools we have supported in our early grant-making, and what we learned is helping us adjust our priorities. These schools are revamping their cultures and creating environments where it's easy to learn, but their students still aren't excelling on tests. We will continue to emphasize great teaching and challenging classes as well as structural reform so that these new and better schools can reach the goal they've been working toward: graduates who are ready for college and work.



GREATER EXPECTATIONS

States raise the bar for schools and students.

“America’s high schools are obsolete.” That was Bill Gates’ message to the National Governors’ Association (NGA) at its 2005 National Education Summit on High Schools, held in February in Washington, D.C. Building on the ideas and momentum generated at the summit, the NGA and Achieve Inc. launched initiatives to help states make education policies that result in higher graduation rates and more rigorous college-preparatory standards.

The NGA’s Honor States Grant Program, partially funded by the foundation, has given grants to 27 states for a wide range of initiatives to improve high schools. To receive a grant, states had to commit to certain policy objectives, including setting goals for higher graduation rates and improving student data collection. Getting better data is vital. Until recently, most states listed artificially high graduation rates—around 90 percent, when they were closer to 70 percent or even lower—because they didn’t factor in students who dropped out before 12th grade. In addition to securing pledges from the 27 Honor States, the NGA got governors from all 50 states to sign a “graduation compact” to demonstrate their commitment to counting graduation rates accurately.

After the National Education Summit, Achieve launched the American Diploma Project Network. The states in the network, which now number 22, all committed to working toward “alignment”—lining up high school graduation requirements and college entrance requirements—and ensuring that state tests are based on college-ready standards.

Together, the NGA Honor States Program and the American Diploma Project have helped the majority of states set priorities that will result in better high schools and more students who are prepared for success in college and work.



CHANGING THE SYSTEM

Districts lead the charge in redesigning high schools.

In past years, our education grants have focused on improvements at the school level. But we learned that helping schools alone is not enough, so in 2005, we devoted more attention and resources to school district reform. We made grants to Atlanta, Austin, Boston, Chicago, Indianapolis, Milwaukee, New York City, Oakland, Portland (Oregon), and five districts in Washington state. Districts are important because they can drive reform at individual schools by providing expertise and resources, including teacher training and curriculum development. And since they're responsible for entire school systems, they can ensure that all students—not just a few—receive a rigorous education.

Many of our district grants were designed to help districts draw up plans to redesign their high schools. For instance, Atlanta Public Schools' grant will support the early planning stages of a redesign effort. Working with several education organizations, Atlanta will develop a strategy to build on the early success of a two-year-old program to transform failing comprehensive high schools into smaller, more dynamic schools. Portland Public Schools, which is further along in the redesign process, will create a diverse group of high-quality high schools and institute standards that match up with what colleges and employers expect high school graduates to know.



EXTREME MAKEOVER: THE HIGH SCHOOL EDITION

MTV gets kids to demand the most from their high schools—and from themselves.

To inspire high school students to take steps to graduate ready for college and become advocates for change in their schools and communities, we supported MTV's *think: Education* campaign. Launched in May, it features a Web site and public-service announcements, news segments, and documentaries. The campaign reached more than 13 million young people through television programming and online features in its first nine months.

October was MTV's "education month." The network highlighted the issue on the air every day and premiered "Think Over Your School," a show about students in Brooklyn who transformed their cafeteria into an all-purpose student center with meeting rooms, performance space, artistic displays, and computer stations. After the show aired, more than 1,000 high schools entered a contest to win a grant to "think over" their schools.



LEARNING OUR LESSONS

Data on high schools show mixed results from our early grantmaking.

As policymakers and the general public become more aware of the great need to reform America's high schools, it's natural to expect that redesigned or new high schools will show immediate results. But the progress in the schools and districts with which we have partnerships will be gradual, particularly in places where young people and school systems have been neglected for decades. We are committed to evaluating our progress so we can identify our successes and challenges, share the lessons we've learned, and make course corrections as necessary.

In 2005, we released quantitative and qualitative data and analyses of our partner schools from the 2003-2004 school year. Overall, the schools posted gains, but more progress was made in new schools than in old schools that were redesigned. Most schools fostered stronger relationships between students and staff and increased the relevance of their coursework. However, classes—math classes in particular—were not always more rigorous and were in some cases less rigorous than at comparison schools, and as a result, students' test scores were disappointing.

The lessons we learned from this earlier work have informed both our strategies and the work of our partners:

- At the school level, we recognize that new schools tend to be more successful than old schools that have been redesigned, and we continue to emphasize the role they play in any district's strategy. School developers—organizations that help design schools and provide strict management guidelines—have shown that they can create thriving cultures in their schools on a shorter timeline, which allows staff to pay more attention to learning and student achievement.
- Small schools and learning communities continue to be a critical component of our strategy. But there is a risk in overemphasizing a school's structure and size: It can delay improvements in curriculum and instruction. A balanced strategy should recognize that rigor, relevance, and high-quality instruction are at least as important as relationships and the size of the school.
- We understand that districts are essential to improving schools. Individual schools cannot succeed without assistance in developing curricula, training and supporting teachers, and devising personnel policies.



HIGHER ED, WITHOUT THE DEBT

Five years of scholarships make college possible for thousands of talented minority students.

2005 marked the fifth anniversary of the Gates Millennium Scholars (GMS) program, a 20-year, \$1 billion scholarship program for academically talented, low-income minority students. So far, the GMS program has awarded scholarships to 9,050 students. And in 2005, an evaluation found that these students are far more likely to graduate from college than their peers around the country.

We created the GMS program in 2000 because data showed that every year, thousands of qualified minority students don't go to college because they can't afford it. Administered by the United Negro College Fund, the GMS program provides what are known as last-dollar scholarships: GMS covers all costs not defrayed by financial aid. GMS scholars don't need to rely on loans or work study; the idea is to allow these talented young people to focus on school and graduate without debt. The GMS program also offers continuing scholarships to recipients who choose to pursue graduate degrees in fields where minority students are underrepresented.

The National Opinion Research Center at the University of Chicago has kept data on the Millennium Scholars since the program started. For the first cohort of students who received scholarships, the five-year graduation rate is 80 percent, well above the national average of 51 percent.



OVERVIEW

Every year, millions of people in the developing world die from diseases that have been virtually eliminated in the developed world. Malaria, to take just one example, kills 1 million people annually—most of them children in Africa. Lifesaving vaccines, drugs, and other health tools often fail to reach those who need them most, and very little health research is devoted to meeting the needs of poor countries.

Our Global Health program prioritizes the diseases and health conditions that represent the greatest burden in developing countries and the solutions that promise to improve health for the greatest number of people. We pursue a two-pronged strategy: We help make sure that proven health tools are widely accessible, and we help drive the development of new tools to prevent and treat serious diseases.

In 2005, our global health grantees continued to make important progress in developing and delivering these tools. In the fight against malaria, grantees made gains in expanding access to anti-malarial bed nets and treatments and in advancing the development of more effective malaria medicines and a vaccine. In the fight against another deadly infectious disease, meningitis, the Meningitis Vaccine Project—in partnership with researchers in India—took important steps forward on clinical trials of a new vaccine. And the Grand Challenges in Global Health initiative, a major effort to promote innovation in global health research, announced 43 groundbreaking projects to discover new ways of preventing and treating a range of diseases in developing countries.

Foundation grantees also focused on raising the visibility of global health issues and on mobilizing new champions and resources for global health. For example, the Global Alliance for Vaccines and Immunization garnered support from five donor countries for a major new initiative that will fund immunization programs in developing countries. The year concluded with a landmark summit on global health in New York and several high-profile media events that helped build public awareness of global health issues.



THE FIGHT AGAINST MALARIA

Grantees' efforts could help turn the tide of malaria in Africa.

Malaria was eradicated from the developed world decades ago, yet in Africa it still kills 2,000 children every day. In 2005, the foundation supported the efforts of a number of grantees to fight the disease on two fronts: by stepping up efforts to control malaria using existing prevention and treatment tools, and by accelerating the development of new tools.

With the support of a \$35 million foundation grant, the Seattle-based organization PATH is working with the government of Zambia and other partners to help cut malaria deaths in that country by 75 percent. The partnership—called MACEPA, for Malaria Control and Evaluation Partnership in Africa—will document the impact of a national malaria-control program that will provide widespread access to insecticide-treated bed nets, effective drug treatment, and other tools. MACEPA's findings will provide critical information for other malaria-affected countries and donors.

While providing greater access to current tools could significantly reduce malaria deaths, developing new tools is also an urgent priority. In October, we announced grants totaling \$258.3 million to spur innovation in three critical areas of malaria prevention and treatment:

- **Malaria vaccine:** The PATH Malaria Vaccine Initiative is working with Glaxo-SmithKline Biologicals and African scientists to conduct advanced clinical trials of the RTS,S vaccine candidate, which has been shown to protect young children from severe malaria over an 18-month period.
- **New drugs:** The Medicines for Malaria Venture is developing a new generation of malaria treatments, an effort that has gained new urgency as drug resistance has rendered the cheapest and most widely used malaria drugs useless in many parts of Africa.
- **Mosquito control:** The Innovative Vector Control Consortium, based at the Liverpool School of Tropical Medicine, is developing new methods for controlling malaria-transmitting mosquitoes, including longer-lasting bed nets and more effective, safer insecticides.



BREAKTHROUGHS FOR THE DEVELOPING WORLD

Leading scientists kick off research that could transform health in the poorest countries.

Very little medical research is devoted to the health problems that disproportionately affect people in developing countries. To help encourage the best scientists in the world to tackle these problems, we have established the Grand Challenges in Global Health initiative, a partnership that includes the Foundation for the National Institutes of Health, the Wellcome Trust, and the Canadian Institutes of Health Research. The initiative's goal is to help create "deliverable technologies"—health tools that are not only effective, but also inexpensive to produce, easy to distribute, and simple to use in developing countries. In 2005, the Grand Challenges initiative made its first round of grants.

Launched in 2003, the initiative unfolded in two stages. First, an international scientific board issued a call for ideas: What scientific and technological innovations, it asked, could have the greatest impact on health in the developing world? After reviewing more than 1,000 ideas, the board identified 14 Grand Challenges that, if solved, could save millions of lives in developing countries. These challenges include, for example, vaccines that don't require refrigeration, vitamin-fortified staple foods, and more effective and easy-to-use diagnostic tools. In the second stage, the board issued a call for research proposals based on the 14 Grand Challenges, and scientists from 75 countries submitted more than 1,500 funding requests.

In June, the Grand Challenges initiative announced grants totaling \$436.6 million to support 43 projects. One would develop a chemical to prevent mosquitoes from smelling humans, which could stop them from being able to transmit disease. Another would design a hand-held diagnostic device that could be used in developing countries to test a drop of blood for a battery of diseases. Four others would develop new varieties of cassava, rice, sorghum, and bananas fortified with high levels of essential nutrients. These staple foods dominate diets in many developing countries but lack key vitamins, minerals, and other nutrients.

The Grand Challenges initiative highlights the incredible potential for science and technology to solve some of the most difficult global health challenges. While the projects announced in 2005 are an important step forward, much more needs to be done to engage the world's best scientific minds in highly innovative global health research. We hope this initiative will encourage both public and private funders to increase their support for research on diseases of the developing world.



A SPOTLIGHT ON SOLUTIONS

An international summit highlights opportunities to improve global health.

In November, several events brought unprecedented attention to the health needs of the developing world. International leaders gathered at the *TIME* Global Health Summit in New York to discuss global health challenges and solutions. Hosted by *TIME* magazine and supported by a foundation grant, the landmark event included health and development experts, policymakers, and representatives of business, religious, and community organizations. Sessions included a dialogue with Bill Clinton and Bill Gates, moderated by *TIME* Managing Editor Jim Kelly, about the role Americans can play in improving the health of the world's poorest people.

The summit coincided with two major media events: a *TIME* special issue on global health, and the PBS television series "Rx for Survival," which was supported by the foundation. Both featured compelling stories of heroes who are fighting on the front lines to make health a priority and save lives. Together, *TIME*'s special issue and the PBS series reached tens of millions of people with information about the most serious health challenges facing developing countries and offered practical steps for people to take action to help solve these challenges.



SELLING BONDS TO SAVE LIVES

A new financing method could raise billions of dollars for vaccines.

Every year, millions of children in the developing world die or become seriously ill because they do not receive immunizations that are standard in the developed world. In 2000, the foundation joined with a diverse group of public and private partners to create the Global Alliance for Vaccines and Immunization (GAVI) to help ensure that all children have access to vaccines. The foundation has provided a total of \$1.5 billion to GAVI since its inception, including a \$750 million grant announced in January 2005. Also in 2005, GAVI generated unprecedented support from donor countries.

GAVI pools the resources and expertise of its partners to support national immunization programs in 72 of the world's poorest countries. GAVI has already reached tens of millions of children with new and underutilized vaccines and prevented an estimated 1.7 million deaths.

In September, five European governments pledged support for an innovative effort to help expand GAVI's critical work. The new International Finance Facility for Immunization (IFFIm) will issue bonds against countries' long-term aid commitments with the goal of raising up to \$4 billion for GAVI. These "immunization bonds" have the advantage of unlocking the full value of multiyear aid packages immediately, when they can have the greatest impact, and providing more predictable, stable funding for immunization programs. Not only could IFFIm help GAVI save an estimated 10 million lives over the next decade, but it also represents a creative new approach to financing global health solutions.



A NEW PARTNER FOR PREVENTION

A unique consortium works toward an affordable meningitis vaccine.

In the “meningitis belt” of sub-Saharan Africa, epidemics of the disease occur frequently. Meningitis can strike suddenly, killing about 10 percent of patients within 48 hours of the onset of symptoms. About 20 percent of meningitis survivors live with severe, permanent disabilities.

Although meningitis vaccines exist, the more effective conjugate vaccines are too expensive for developing countries, while the cheaper polysaccharide vaccines don't produce long-lasting protection, don't protect children under 2, and don't block transmission of the disease.

In 2005, the Meningitis Vaccine Project (MVP) and the Serum Institute of India Limited (SIIL) conducted Phase I trials on a new vaccine candidate that could offer important improvements over current meningitis vaccines. The new vaccine, whose development is supported by a \$70 million foundation grant, is expected to cost just 40 cents a dose, making it affordable for African countries. To produce a vaccine at this price, however, MVP was forced to adjust its initial strategy.

Affordability is a priority for MVP because even the highest-quality vaccine won't save lives if the people who need it don't have access to it. In 2000 and 2001, before vaccine development started, MVP staff had extensive discussions with African health officials, who helped them determine how low the price would have to be to facilitate widespread use of the vaccine. MVP set a target price of less than \$1.

In 2001, MVP approached major pharmaceutical companies to discuss developing meningitis vaccines for use in Africa. However, it became clear that manufacturers in industrialized countries would be unable or unwilling to meet the target price, and MVP explored alternative strategies to develop the vaccine. The solution MVP settled on was to build a consortium of partners and transfer the technology required to make the vaccine from the United States to a manufacturer in India.

MVP helped oversee a process in which a company from the Netherlands provided some of the basic components of the vaccine, the U.S. Food and Drug Administration provided the technology, and SIIL agreed to develop, test, and manufacture the vaccine.

Not only will the meningitis vaccine candidate move on to the next phase of trials in 2006, but MVP's consortium model may be adaptable to accelerate vaccine development for other diseases that affect poor countries.



OVERVIEW

In the United States and around the world, libraries provide access to information that millions of people rely on—to succeed in school or work, learn about government services, find a job, start a business, or communicate with family and friends. Public access to computers and the Internet is central to the mission of libraries because not everybody has equal access to those technologies. Many people—because of how much they earn, where they live, or what skills they lack—are on the wrong side of the digital divide. They are living during—but not in—the Information Age.

In 2005, our Global Libraries Program aimed to close this digital divide by providing free Internet access through public libraries in the United States and in other countries around the world. We've been working with U.S. libraries since 1997. Over six years, our team installed 47,000 computers with the cooperation and support of 11,000 public libraries. Now, according to a recent study, more than 99 percent of U.S. public libraries are online.

In 2005, with this initial project complete, we adjusted our strategy to help U.S. libraries sustain the progress they've made on providing public access computing services. For example, we helped develop a pilot project to train librarians to meet the public access computing needs of the rapidly growing Spanish-speaking population. We also supported research that helped raise awareness about the challenges libraries face in providing public access computing programs.

We also focused on expanding our International Library Initiatives. Building on successful collaborations with Canada, Chile, and the United Kingdom, we worked closely with Mexico on its effort to wire thousands of libraries, and the lessons we learned there will improve our partnerships with other countries in the future. In addition, we asked three countries interested in launching public access computing programs in their libraries to apply for grants. We're now working closely with those countries to develop sustainable local initiatives. We plan to announce those countries publicly in 2006, and in the coming years we hope to build partnerships with 12 to 15 additional countries.

Because our U.S. program and international initiatives pursue different strategies to meet the distinct needs of libraries in the United States and the developing world, the Global Libraries Program split into two separate entities in 2006. U.S. Libraries became part of our new U.S. Program, and International Initiatives became part of our new Global Development Program.



BACK ON TRACK

After early setbacks, Mexico is wiring 2,000 libraries.

In 2002, we made a grant to Mexico's ministry of culture, Consejo Nacional para la Cultura y las Artes (CONACULTA), to support public access computing in about one-third of the country's 6,000 libraries. In October, we made the final payment of the \$30 million grant. We anticipate that Mexico will be able to provide public access computing in 2,200 libraries—7 percent more than its original goal. Despite this success, in the spring of 2005, before the final payment was made, the project faced major challenges.

The most significant problem was a lack of capacity to manage such a complex program, which was especially evident in the project's connectivity component; about half the libraries that were supposed to be wired by 2005 weren't, and the half that were wired didn't have adequate bandwidth. In April, we expressed our concerns during a meeting with key players in Mexico. Mexican officials spent the next two months diagnosing problems and devising a revised plan that included a detailed timetable and spelled out specific milestones toward the desired connectivity and other key goals. With additional foundation funding, they also hired two new project managers. These efforts got the project back on track, and we made the third payment.

We learned a number of valuable lessons from this experience that will inform our strategies for future projects in other countries:

- We must focus on project management. We included funds for project management in our third grant payment to Mexico and will continue to do so for future international grants.
- We must give more consideration to collaboration within governments. We worked primarily with CONACULTA, but to get the project done, the ministries of education and communication and transportation had to be involved as well. Now these ministries are working together. Our future efforts will also involve national, state, and municipal governments.
- We must develop feasible, step-by-step plans in partnership with countries. Mexico's original plan was developed by a private consulting firm, and Mexico's team believed it didn't have enough input and didn't feel invested in its success.



SUPPLY AND DEMAND

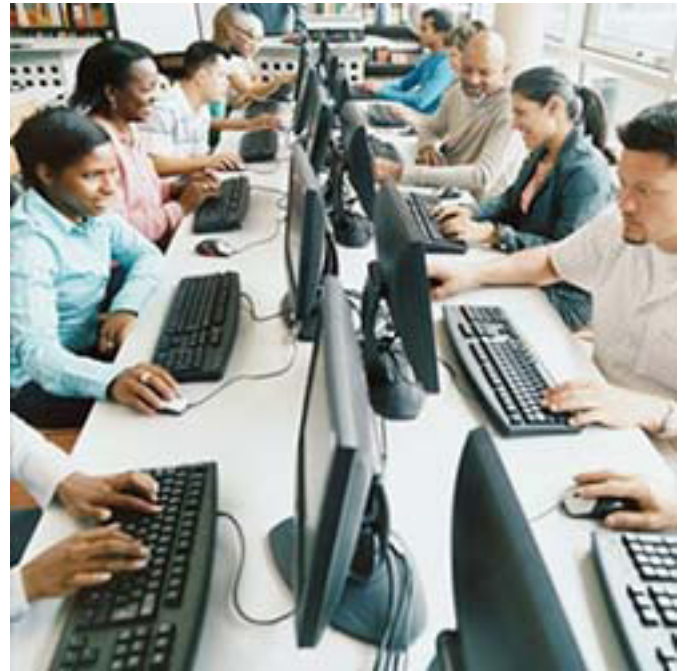
More U.S. libraries than ever are online, but they are struggling to keep up with high demand for Internet access.

As we focus on helping libraries sustain their public access computing programs, it's important to understand the progress they have made as well as the challenges confronting them. In June 2005, a report by the Information Use Management and Policy Institute at Florida State University looked at both questions.

The report showed that virtually all public libraries in the United States, 99.6 percent, are connected to the Internet. That's almost a fivefold increase since 1994, the first year the survey was done, when only 20.9 percent of libraries were online.

Despite this progress, the study, funded jointly by the foundation and the American Library Association, also demonstrated that most libraries are struggling to satisfy the demand for public access computers. According to the report, 85 percent of libraries don't have enough computers to meet demand. Fewer than half have high-speed connections. Moreover, most libraries face considerable budget pressures. About 65 percent have to make do with technology budgets that remain flat or decline from year to year, which makes it extremely difficult to develop plans for maintaining or upgrading public access computing programs.

With these findings, we are working with librarians across the country to advocate for more resources, demonstrate the importance of providing public access computers to marginalized populations, and meet the tremendous demand for public access computing. The Florida State team will conduct another survey in 2006 to collect more specific information about the common challenges libraries face.



SURFING IN SPANISH

To bridge the digital divide, U.S. libraries are crossing the language barrier.

Sustaining public access computing in public libraries requires that these services be relevant and accessible to local communities. According to 2002 U.S. Department of Commerce data, only 31.6 percent of Hispanics used the Internet in public libraries, ranking them near the bottom of all demographic groups. Despite these national statistics, the libraries we worked with in many states reported heavy demands for computers that were formatted for Spanish-language use. Moreover, library staff told us they needed more support to communicate with and train Spanish speakers who wanted to use public computers. These insights, combined with the extraordinary growth of the Hispanic population, convinced us that an investment in outreach to Spanish-language communities was critical.

To promote sustainability, U.S. libraries are crossing the language barrier to reach Spanish-speaking patrons. Our grantee WebJunction, which helps librarians work with technology, launched a Spanish-language pilot program at the end of 2004 to help libraries reach out to Spanish speakers. The program started in four states: Colorado, Florida, Illinois, and New Mexico. At the end of 2005, it had expanded to 11 states, and more states are planned for 2006 and 2007.

The pilot program is designed to train librarians to conduct workshops in their own communities to help libraries assess the needs of Spanish speakers, offer more Spanish-language services, and build better relationships with Spanish speakers by improving promotional efforts and forming partnerships with community organizations. These efforts will not only make libraries more relevant in Hispanic communities but will also help sustain public access computing programs in libraries that serve these communities.

The results from the first four states were encouraging. Half of the participating libraries offered Spanish-language computer classes after the workshops, compared to 35 percent before the workshops. Nine percent of these libraries built new partnerships with Hispanic groups after the workshops, and 46.4 percent strengthened existing partnerships.

Based on feedback from the early states, WebJunction plans to enhance the program as it moves into more states. It will add an extra day to the training, include follow-up training for librarians who complete the first session, develop self-paced online classes, and conduct surveys in Spanish-speaking communities to gauge the program's impact more effectively.



A LEVEL PLAYING FIELD

Our final round of hardware grants is helping U.S. libraries replace outdated computers.

We are in the process of shifting our strategy from installing computer hardware in public libraries across the country and connecting them to the Internet, to help these libraries sustain and build up their public access computing programs. As part of this transition, we launched the Public Access Computing Hardware Update Grant program in January to help libraries with older computers catch up.

The program grew out of a 2004 study, conducted by the Public Access Computing Project at the University of Washington, which revealed that one in four libraries that received computers from us between 1997 and 2000—during the initial phase of the U.S. Library program—had been unable to make necessary upgrades to sustain their public access computing programs. The one-time grants, totaling \$34 million, will pay for more than 27,500 computer upgrades at more than 5,000 libraries where the foundation's original granted computers were not configured for on-going upgrades. The grant program will level the playing field so all libraries have sustainable computing hardware and can benefit equally from our new approach.

Findings from a survey completed by grantees gave us valuable first-hand information on what's working as well as on the challenges they face in sustaining public access computing in U.S. public libraries. Our grantees told us they're offering more technology training; attracting new patrons, including immigrants, by emphasizing technology services; and contributing to economic development by providing public access to computers and the Internet.

The challenges libraries face include: the need to increase bandwidth as patrons come to expect faster connections; serving patrons' need for increasingly complex computer applications and training; preparing staff to work more comfortably with technology; and prioritizing public access computing amid libraries' other urgent needs.

We believe it's crucial to transfer long-term responsibility for public access computing to governments and a range of private funders. Helping libraries measure and demonstrate the value of public access computing is a critical next step in that process.



OVERVIEW

Washington state has some of the highest rates of unemployment and hunger in the nation. On any given night, thousands of families in Washington will be homeless. Each year, more than half the children starting kindergarten in the state aren't ready to learn. Our Pacific Northwest program seeks to improve the lives of vulnerable children and families in Washington state and Greater Portland, Oregon. Our goal is to ensure that all children in our region have a safe place to sleep at night and the opportunity to succeed in school and life.

In 2005, we focused on three areas of giving: community grants to a variety of nonprofit organizations in our region that work with low-income children and families; "supportive housing," a solution to homelessness that combines affordable housing and social services; and early learning efforts to ensure that all children in Washington are ready to start kindergarten. We launched our early learning strategy in 2005. In 2006, our early learning and high school efforts were combined in an expanded Education portfolio. This change will help the teams work together and share lessons from their work on different aspects of education reform.

Since it's absolutely critical to work together with business, government, and non-profit organizations in the community, 2005 was about strengthening these partnerships in all our initiatives.

For example, the Washington State Legislature created a statewide public-private partnership for supportive housing, the Washington Families Fund, in 2004. The fund launched in 2005, bringing together 13 different private funders and over 100 different individual donors whose commitment to fighting homelessness will help dozens of housing and service providers across the state sustain this innovative housing approach for years to come. In addition, in devising our early learning strategy, we collaborated with numerous business, government, and non-profit leaders to gather ideas and work toward increasing school readiness for all children in Washington state. We spent much of the year working to fashion a statewide public-private partnership to help lead the early learning movement in the state. These and other partnerships ensure that we're pooling resources and expertise with others in the region to have the greatest impact on the lives of vulnerable children and families.



STEADY FUNDING FOR STABLE HOMES

A new partnership extends a solution for homelessness throughout Washington state.

In 2004, the Washington State Legislature established the Washington Families Fund (WFF), a public-private partnership to help fund “supportive housing,” an innovative approach to solving homelessness that combines affordable housing and critical services such as job training and domestic-abuse counseling. In 2005, the WFF achieved immediate success, attracting 13 funders who contributed more than \$3 million to the fund (on top of the legislature’s initial \$2 million allocation) and making grants totaling \$2.64 million to 10 providers. These grants could reach as many as 5,000 Washington families over the next decade, helping them find a permanent place to live.

The Washington Families Fund was largely inspired by the Sound Families Initiative, a Gates Foundation-funded effort to triple the inventory of supportive housing in King, Pierce, and Snohomish Counties. Sound Families was launched in 2000, and a series of evaluations since then has measured the impact of the supportive housing approach. (For example, the most recent evaluation showed that about two-thirds of families who participated in the program went on to find permanent housing.) This evidence that supportive housing works was chiefly responsible for spurring the legislature to establish the WFF and adopt the approach long-term and statewide.

Administered by AIDS Housing of Washington, the WFF received 50 grant proposals for its first round of funding. Each of the 10 grants awarded will serve about 500 families over the next decade. They will pay for one-third of the cost of service-enriched housing programs; the remaining two-thirds will come from other funding sources, to ensure that housing and service providers remain invested in the supportive housing approach.

The second round of funding will be announced in the summer of 2006. With motivated funders and great demand for grants, the WFF is building momentum toward its goal of reducing family homelessness in Washington state.



GIRLS FIRST

A mentoring program helps low-income young women become leaders.

In 2004, we commissioned a report to help us understand how successful young adults develop. The report confirmed our belief that mentoring is one of the best, most cost-efficient strategies for improving the prospects of vulnerable young adults. As a result, in July we made a community grant to the Seattle-King County YWCA's GirlsFirst program.

GirlsFirst is a leadership program for low-income girls of color entering the ninth grade. It aims to build their confidence, improve their academic performance, and encourage them to think ambitiously about career opportunities. The program provides adult mentors, academic support, and leadership training in a variety of settings, including a retreat at Seattle University, a three-week summer academy, and monthly "Action Days." The intensive portion of the program lasts a year, but the YWCA offers ongoing activities for GirlsFirst alumni, aimed at making sure they graduate from high school.

Our grant will allow GirlsFirst to accept more girls every year and help it expand into South King County, where many low-income families now live. In addition, the grant will fund the first comprehensive evaluation of GirlsFirst, both to ensure that it's achieving its goals and to provide a better understanding of whether it can be replicated.



STATE OF READINESS

Our new strategy aims to ensure that all children in Washington are prepared for kindergarten.

In 2005, we developed a long-term, statewide early learning strategy that will focus our work in Washington state. We will work with public and private partners across the state to ensure that every child is given the opportunity, from birth, to succeed in school and life. In 2006, our early learning efforts were combined with our high school efforts as part of an expanded Education portfolio. This change will allow the teams to communicate more effectively about the common challenges they face.

Three-fourths of all children in Washington's lowest-income classrooms start kindergarten socially, emotionally, physically, or cognitively unprepared for school. They fall behind, and the likelihood is that they'll never catch up. A wealth of research, however, shows that exposing children to high-quality early learning environments (either at home, in child-care centers, or in other settings) during the key years between birth and age 5 makes a significant difference in their futures. Our strategy is to provide support for parents and families to make sure children have access to high-quality early learning opportunities regardless of where children spend the majority of their day.

In 2005, we worked with our public and private funding partners to begin the process of building a partnership focused on taking sustainable, high-quality early learning to scale in Washington state. Our strategy is based on three tactics we believe will provide both the evidence and infrastructure needed to advance this effort statewide.

First, we will select demonstration communities where comprehensive early learning initiatives will exemplify the effectiveness of high-quality early learning. Second, we will support efforts in local communities to replicate models that are either proven or hold promise to add to our knowledge about what works well for young children. Third, we will encourage statewide efforts to improve early learning through programmatic initiatives, education, and advocacy efforts.

Working with public and private partners, we are committed to creating a system that ensures the best start for children in Washington. We believe that through these efforts we will see a significant increase in school-readiness rates for all children and a reduction in the school-readiness gap between low-income and high-income children statewide.



CAT'S NEXT LIFE

A key grantmaking program is transformed.

In 2001, we launched the Community Access to Technology (CAT) program, which helps nonprofit organizations in Washington state give their low-income clients opportunities to learn the skills they need to use technology. In April, we announced that the program would begin a partnership with the Washington State University Center to Bridge the Digital Divide. The program has been renamed Communities Connect, and the Center will oversee its transformation from a private grantmaking program funded by the foundation into a network of community-technology organizations and advocates throughout the state.

Over five years, we've made more than 100 grants totaling \$16 million through CAT. About 80,000 people, most of them from groups that typically don't have access to computers or the Internet, were served at 350 different locations throughout the state. Communities Connect will help sustain and grow these efforts.



OVERVIEW

In May 2005, we launched Strategic Opportunities, a group of learning initiatives to help us analyze potential new areas of giving. Strategic Opportunities explored a variety of areas and determined that three areas—agricultural productivity and development; financial services for the poor; and water, sanitation, and hygiene—were likely to have a significant impact and were a particularly good fit with our strengths and interests.

The principle underlying Strategic Opportunities in 2005 was learning by doing. We conducted research and gathered input from key leaders in these fields to identify potential points of intervention and to assess the impact we could have if we make commitments in these areas. We are grateful to all those who have generously shared their time and expertise with us. Through this work we developed preliminary strategies and grant portfolios that tested our early strategic thinking while we continued learning. We hope our grants will have a positive impact in the short term, even as they help us understand what our involvement could be in the long term.

In 2006, these learning initiatives became part of our new Global Development Program, which aims to help people around the world overcome the tremendous inequities of extreme poverty.

In 2005, in addition to launching these areas of learning, we made a limited number of grants that fell outside our main areas of giving. We made a few one-time grants for special projects to take advantage of unique opportunities to make a great impact and to reflect personal interests of the Gates family. For example, we made a grant to help start a university for Asian women from underprivileged backgrounds. We also donated \$3 million to organizations working on the relief effort after Hurricane Katrina, and we helped support the Computer History Museum in Mountain View, California.

Finally, we believe we have a responsibility to support the charitable sector as a whole—to help other foundations and nonprofits be as effective as possible. So, we make grants that support U.S. organizations that are serving and strengthening the charitable sector. In 2005, these grants totaled about \$3.2 million and went to eight organizations.



CLEAN AND CLEAR

Cleaner water, better sanitation, and improved hygiene can save millions of lives.

More than 1 billion people throughout the world lack access to clean water, and 2.5 billion don't have access to basic sanitation facilities such as toilets. Billions more don't follow adequate hygiene practices, such as washing their hands. As a result, 1.5 million children under 5 years of age die every year from diarrhea and other water-related illnesses. Countless hours of productivity are lost to the search for clean water, and the social consequences are profound as well (for example, many girls don't attend school because they need to travel long distances to collect water or because the schools have no sanitation facilities).

In August 2005, we launched an initiative to make a limited number of grants to address these problems and to learn if we can play a significant role in improving water, sanitation, and hygiene in the developing world over the long term. This learning process will continue in 2006.

Most investment in water and sanitation has been focused on large infrastructure projects in urban areas. These services rarely reach the most needy groups, including the rural population and the poor who live in urban slums. In our grant-making, we are exploring commercial and other solutions that make self-sustaining water and sanitation services available and affordable for the poor. We also hope to spur technological innovation in the water and sanitation fields and to help launch initiatives to encourage changes in hygiene and sanitation practices that would lead to greatly improved health as well as economic and social benefits.



PROSPECTS FOR GROWTH

Innovation in agriculture helps alleviate hunger and poverty.

The vast majority of the poorest people in the world—those living on less than \$1 per day—live in rural areas. They grow their own food, much of which does not provide the basic nutrients they need to be healthy. Consequently, it is impossible to reduce poverty and hunger significantly without addressing agricultural productivity and development. In 2005, we began the process of exploring whether we can play a long-term role in this effort. In 2006, our learning had progressed to the point that we decided to expand significantly our investments in agricultural productivity and development.

Since the early 1960s, when leading institutions like the Rockefeller Foundation helped initiate the Green Revolution, improvements in agriculture have transformed the lives of billions of people. Despite these successes, agriculture hasn't been a priority in the field of development for several decades, and existing global agricultural research and development has failed to address many of the priorities of small farmers. Moreover, agricultural advances that are relevant to the poor don't always reach those for whom they were intended. For example, Africa lags far behind Asia in adopting the higher-yielding crop varieties that have been developed over the past 40 years. Solving this problem is particularly important because new technological advances may allow for significantly improved crops, such as drought-tolerant maize, that could contribute dramatically to the well-being of poor farmers.

We are making investments that address four priority areas: applying the latest bioscience to crops important to the poor; improving local breeding and extension efforts to reach farmers with locally appropriate seeds and other inputs; strengthening access to markets for small farmers; and initiating efforts to improve policy- and decision-making in agriculture.



BANKING AGAINST POVERTY

Financial services can help the poor improve their lives.

Access to financial services such as credit, savings, insurance, and money transfers can help hundreds of millions of people who live on less than \$2 per day pull themselves out of poverty. These services enable the poor to build assets and increase their incomes while also protecting them from the financial consequences of natural disasters, health emergencies, and business setbacks. In July 2005, we launched an initiative to evaluate how our involvement can help significantly reduce poverty over the long term by expanding access to financial services amongst the poor. In 2006, our learning had progressed to the point that we decided to expand our commitment to help achieve this goal.

Since the 1970s when pioneering institutions like Grameen Bank and BancoSol began offering uncollateralized loans to the poor, we have seen the emergence of thousands of financial services providers focused on low-income markets. However, only 10 such institutions currently serve more than 1 million clients, and most of them have taken several decades to grow that large. And more than 80 percent of the poor still lack access to financial services.

Given the importance of these financial services, we are exploring opportunities to bring to scale a broad range of sustainable financial services—not just credit. For example, we formed a partnership with the Aga Khan Foundation USA team to develop and test a range of insurance products that can protect the poor from financial shocks related to weather, fire, and illness in Pakistan and Tanzania. In Pakistan, the products will be tested and delivered through Aga Khan's First Micro-Finance Bank, which recently received an award for financial transparency from the World Bank. We also recognize that reaching many more poor households will require working through a broad range of institutions: microfinance organizations, commercial banks, and state-owned retail banks. We are beginning to make investments in each of these areas.



SPECIAL OPPORTUNITIES

Projects that fall outside our major giving areas.

Some of our work falls outside our main areas of giving. Our Special Opportunity grants are typically one-time investments that enable the foundation to respond creatively to issues that are related to but not clearly within defined strategies. They might also respond to unanticipated events or provide opportunities to learn about challenges we face through discussions with experts outside our established networks.

In the days immediately following Hurricane Katrina, for example, we made a series of grants designed to help those most in need. Our grants, totaling \$3 million, went to established organizations that could have a significant and immediate impact, including the American Red Cross, the Baton Rouge Area Foundation, America's Second Harvest, and the National Association for the Advancement of Colored People. These organizations provided evacuees with food, clothes, medical care, and shelter in the critical days after the storm. Our Education and U.S. Libraries teams have also worked with schools and libraries that were affected by the hurricane.



OVERVIEW

The foundation's condensed statements of financial position, activities, and grants paid for the years ended Dec. 31, 2005 and 2004 are presented in this section.

To present a clearer picture of the endowment balance available for charitable purposes, the foundation has provided condensed financial statement information that departs from generally accepted accounting principles (GAAP) in two ways. First, the accompanying condensed financial statements include only summarized statements of financial position and statements of activities and do not include statements of cash flows or the footnote disclosures. Second, the foundation has combined investments loaned under secured lending transactions, liabilities under investment loan agreements, investment sales receivable, and investment purchases payable and included the net result within investments.

The foundation's financial statements undergo an annual audit, which is conducted by KPMG. They audited our financial statements for the years ended Dec. 31, 2005 and 2004, which are presented in conformity with GAAP, and they expressed an unqualified opinion on these financial statements. A copy of KPMG's audit report dated March 24, 2006, may be viewed on our Web site.

Additional information about the foundation can be found in our 2004 annual information return, called the Form 990-PF-Return of Private Foundation, which is available in our Annual & Financial Reports section of our Web site.

The 2005 annual information return will be available on our Web site after it is filed in late fall, 2006.

Allan C. Golston, C.P.A.

Chief Financial and Administrative Officer

MANAGEMENT DISCUSSION & ANALYSIS

As I wrote in my Letter From the CEO, one of the foundation's goals for the coming years is to make sure we tell our partners and the public what we're doing, what we're learning, and what impact our grants are having. This Management Discussion, the first in an annual series, is one attempt to live up to that goal. I want to answer some of the questions that people ask me and my foundation colleagues. Because many of those questions are about the inner workings of the foundation, this letter is more internally focused than the rest of this year's annual report.

Structure and Governance

In 2005, our grantmaking programs were organized into four main areas: Global Health, Education, Global Libraries, and Pacific Northwest. (As we explain in the Other Initiatives section of this report, we also made grants in additional areas, including microfinance; agricultural development; and water, sanitation, and hygiene.) In 2006, we reorganized the foundation to allow for growth and greater impact in the years ahead. In part, this reorganization involved creating three new high-level positions: presidents who will oversee our work in the United States, in Global Health, and in Global Development. You can read about these changes and our new leaders on our Web site.

I'm often asked: Why doesn't the Gates Foundation have a board of trustees? The answer boils down to the fact that Bill and Melinda—our two trustees—are deeply involved in the foundation's work. They want to keep learning as much as they can and shaping our strategies so their wealth can do the most good for the most people. They want this foundation to be able to act quickly, responding to the problems that we've identified and to new ones as we learn about them. And they feel that they're best able to do that by maintaining control themselves.

Yet Bill, Melinda, Bill Sr., and I have served on many boards ourselves, and we know they play a crucial role by bringing in outside voices and raising tough strategic questions. Because we don't have a board, we need to find other ways to do the same thing. That's why, throughout the organization, we actively seek out input and ideas from the outside. All of our programs involve a variety of highly credible outsiders who are close to our issues in program development, strategy development, and grantmaking.

For example, when we established our \$450 million Grand Challenges in Global Health initiative, we appointed a scientific board—with 20 out of its 22 members from outside the foundation—to reach out to the entire global scientific community in order to help define a list of challenges for exploration that, if solved, could bring about enormous health benefits for people in the developing world. The initiative is benefiting enormously from this extensive outside input.

We also brought in outside advisers to help our Global Libraries program explore working with new countries. These experts, who were leaders in library development and public access computing, helped us revise our methods for choosing countries and our approaches to working with them.

Because we have gained so much from outside experts in the past, we've been thinking carefully about how we can get that advice in the most consistent and effective way. In the next few months, we plan to establish a more formal advisory system; when we do, we will announce it on our Web site.

Grants

Another question I'm often asked is: "Who approves grants?" Not surprisingly, the answer depends on the size of the grant. While I don't want to publish the details of who can approve which grants, I will say that our spring 2006 reorganization gave significant grantmaking authority to the presidents of our three major programs (the U.S. Program, the Global Health Program, and the Global Development Program). Most grants are now approved by directors within the programs, by the president they report to, or by me. This will decentralize authority and make us able to respond more quickly. Very large grants are still approved by Bill and Melinda. But we believe the best way for them to spend most of their time on foundation business is to help us formulate and refine our strategies and bring attention to the issues we care about.

Endowment

A third area I'm frequently asked about is the foundation's endowment. Who manages it? What kind of returns do we get?

The foundation's portfolio is managed by an external investment team called BGI, which also manages Bill Gates' personal portfolio. BGI is based in Seattle and led by Michael Larson. Bill and Melinda donate BGI's services to the foundation, as well as the cost of third-party investment managers hired by BGI to manage part of the foundation's portfolio. Bill and the foundation are BGI's only clients.

MANAGEMENT DISCUSSION & ANALYSIS

Our investments are designed to ensure that the foundation has a stable financial base with which to make grants and pursue its mission for the long term. Because they intend to donate more of their own money to the foundation over time, Bill and Melinda feel that the endowment does not need to grow aggressively through investments. Therefore, they have asked BGI to manage it fairly conservatively, aiming for a 5 percent nominal return each year. Since 1999, the portfolio has earned more than that goal—an average of 8.53 percent a year.

We maintain a strict wall between our programmatic work and BGI's management of the portfolio. BGI is not involved in decisions about grants, and the foundation's program staff is not involved in decisions about investing the endowment.

Payout

The Internal Revenue Service requires private foundations to distribute at least 5 percent of their average endowment over the course of a year. We generally exceed this requirement by a small percentage. As a result, from 2000 to 2004, the foundation distributed \$376,049,274 more than was required by law.

Grants Paid

The table below shows the grants paid by our different program areas for 2004 and 2005, followed by a brief explanation of the increases and decreases from one year to the next.

PROGRAM AREA (\$ in millions)	2005	2004	% Change
Education	\$ 284.3	\$ 708.4	-59.9%
Global Health	843.7	442.0	90.9%
Global Libraries	25.0	24.9	0.4%
Pacific Northwest	75.1	37.8	98.7%
Other Initiatives	128.2	39.2	227.0%
TOTAL GRANTS PAID	\$ 1,356.3	\$ 1,252.4	8.3%

Global Health

Several factors contributed to the 90.9 percent increase in Global Health grants between 2004 and 2005. In 2005 we made the first payments in our second \$750 million commitment to the Vaccine Fund. We also made more grants related to the priority health conditions we've identified. Finally, the work we're supporting to develop a new malaria vaccine proceeded faster than we expected, so we made more payments in that area than we had planned.

Education

The decrease in Education grants between 2004 and 2005 is slightly misleading. In 2004 we made the final grant payment to the United Negro College Fund for our \$1 billion commitment to the Gates Millennium Scholars Program. Grants in our U.S. high school program actually increased by more than 30 percent from 2004 to 2005.

Pacific Northwest

The growth in our Pacific Northwest program in 2005 resulted entirely from our one-time \$30 million grant to Bill Gates' high school alma mater, the Lakeside School in Seattle.

Other Initiatives

This category consists mostly of grants made by our Strategic Opportunities team, which explored potential new program areas, though it also includes one-time grants that didn't fall into one of our other areas of giving. It increased in 2005 as the Strategic Opportunities group made initial grants in three areas: financial services for the poor; agricultural development; and water, sanitation, and hygiene. Our Global Development program, which we created in 2006, grew out of the work done by the Strategic Opportunities group.

MANAGEMENT DISCUSSION & ANALYSIS

Stewardship

The past few years have seen some high-profile cases in which foundations and other nonprofits have violated the public's trust and failed to live up to their responsibilities. At the Gates Foundation, we have followed these stories with great interest. They serve as a constant reminder that we have to ask ourselves: How do we make sure we are spending our resources responsibly?

First, of course, we're intensely focused on getting, and sharing, results from our grantmaking. We have established a small internal team at the foundation to help all of us concentrate on results and be self-critical as we develop program strategies, measure the impact of our grantmaking, and become more effective grantmakers.

We also have reviewed and updated our internal policies and processes, and we've implemented new systems as well. For instance, information about each of our grants is available in a searchable database on our Web site. And our travel policy now requires all employees to fly coach on all domestic flights. (Like other nonprofits that do a lot of work internationally, we do allow employees to fly business class on overseas trips of more than five hours so they can make the most of their travel time.)

Our conflict-of-interest policy requires employees to disclose any connection with a potential grantee or vendor. This helps ensure that no one who has a conflict of interest makes a final decision about a grant or contract. We have also created a database that checks every grant and contract so we can identify any potential conflicts.

Our whistleblower policy prohibits retaliation against any employee who reports inappropriate behavior in the workplace. It's important for employees to feel comfortable raising concerns directly with the foundation's leadership, but we have also provided an alternative that lets them make an anonymous report by calling a toll-free number or visiting a Web site run by a third party.

Beyond these two key policies, we have adopted a set of guiding principles that describe how we focus our work. They also set standards for how we want to act. All new employees get a copy of these principles before their first day on the job, and they are expected to live up to them in their daily work.

You can view the guiding principles as well as the whistleblower and conflict-of-interest policies on our Web site.

We also want to be good stewards when setting compensation and benefits for executives. The foundation needs experienced leaders who can manage an organization that is changing and growing. On the other hand, executives' compensation has also become a hot-button issue in the nonprofit sector—especially when it's seen as excessive. I'm also keenly aware that the nonprofit sector is not the same as private industry, and if we pay too much, other nonprofits could have a hard time attracting talented people.

When we're setting an executive's compensation, we work with an outside consulting firm that analyzes the compensation for similar jobs at peer foundations and nonprofits. As our executive positions become more complex, our executive compensation will go up accordingly. That said, many of our employees—executives included—could make more in the private sector, and they choose to stay at the foundation because they're passionate about the work they do. (I am not paid a salary.)

Growth

I'm often asked how much the foundation will grow in the next few years. While it's hard to predict the future, we are definitely hiring more employees as we learn more about the areas where we're working and look for ways to have a bigger impact.

This growth isn't steady—it comes in fits and spurts, as our mission dictates. For instance, as we have wrapped up the first phase of our U.S. Libraries program, the number of employees in that group has dropped, to 10 at the end of 2005 from a high of 132 in 2001.

But on the whole, we are adding to our staff. In 2005, we grew from 197 full-time employees in January to 247 in December. This may still be too lean; in the next few years, we could have as many as 500. While this growth is considerable, and while it presents real challenges for our management team, I think it's the best way to manage our resources responsibly and make sure they have great impact around the world.

MANAGEMENT DISCUSSION & ANALYSIS

Because of this growth, we're running out of room at our current headquarters in Seattle, a space we've been renting since 1999. To accommodate our long-term growth, and to give us a permanent space in our hometown, we are building a new campus in Seattle.

It will be located near Seattle Center, the city's cultural heart, on property that belonged to the City of Seattle.

2005 saw several major milestones for the project. We created IRIS Holdings LLC to handle buying the property from the city as well as planning, design, and development. The City Council approved the sale and purchase agreement for the property. We started meeting with the local community to get to know our future neighbors and get their feedback on our design plans. We also received a key permit for the first construction project on the site—a parking garage. (Seattle Center will own and operate the garage, which will accommodate the foundation's employees and guests as well as Seattle Center visitors.) Construction of the garage should begin at the end of 2006. Many more details about the new campus are available on our Web site.

The Gates Foundation has changed a great deal in the past five years, and it will grow and change even more over the next 10. The organization we put in place in 2006 will help us manage that change. When I think about the decade ahead—the opportunities we all have to improve millions of people's lives—I couldn't be more excited.

Patty Stonesifer
Chief Executive Officer

CONDENSED STATEMENTS OF FINANCIAL POSITION

As of December 31, 2005 and 2004 (Amounts in thousands)

ASSETS		2005		2004
Cash and cash equivalents	\$	183,540	\$	184,026
Investments ¹		28,718,949		28,312,620
Interest and dividends receivable		223,053		278,714
Federal excise tax refunds receivable		1,707		2,850
Program related investment receivable		720		1,440
Property and equipment, net		25,539		18,959
TOTAL ASSETS²	\$	29,153,508	\$	28,798,609

LIABILITIES & NET ASSETS		2005		2004
LIABILITIES:				
Accounts payable	\$	13,442	\$	5,736
Accrued and other liabilities		10,077		19,482
Deferred excise taxes		26,832		34,039
Grants payable, net		2,096,441		1,885,063
Total Liabilities ²		2,146,792		1,944,320
NET ASSETS:				
Unrestricted net assets		27,006,716		26,854,289
TOTAL LIABILITIES & NET ASSETS²	\$	29,153,508	\$	28,798,609

¹ Investments reflected at market value; all other assets shown at cost.

² For purposes of this presentation, the foundation has departed from the presentation required under accounting principles generally accepted in the United States of America by netting amounts loaned and payable under secured lending agreements and by netting investment sales receivable and investment purchases payable. Had these amounts not been netted, total assets for 2005 and 2004 would be \$34,953,381 and \$36,115,584, respectively; total liabilities for 2005 and 2004 would be \$7,946,665 and \$9,261,295, respectively; and total liabilities and net assets for 2005 and 2004 would be \$34,953,381 and \$36,115,584, respectively.

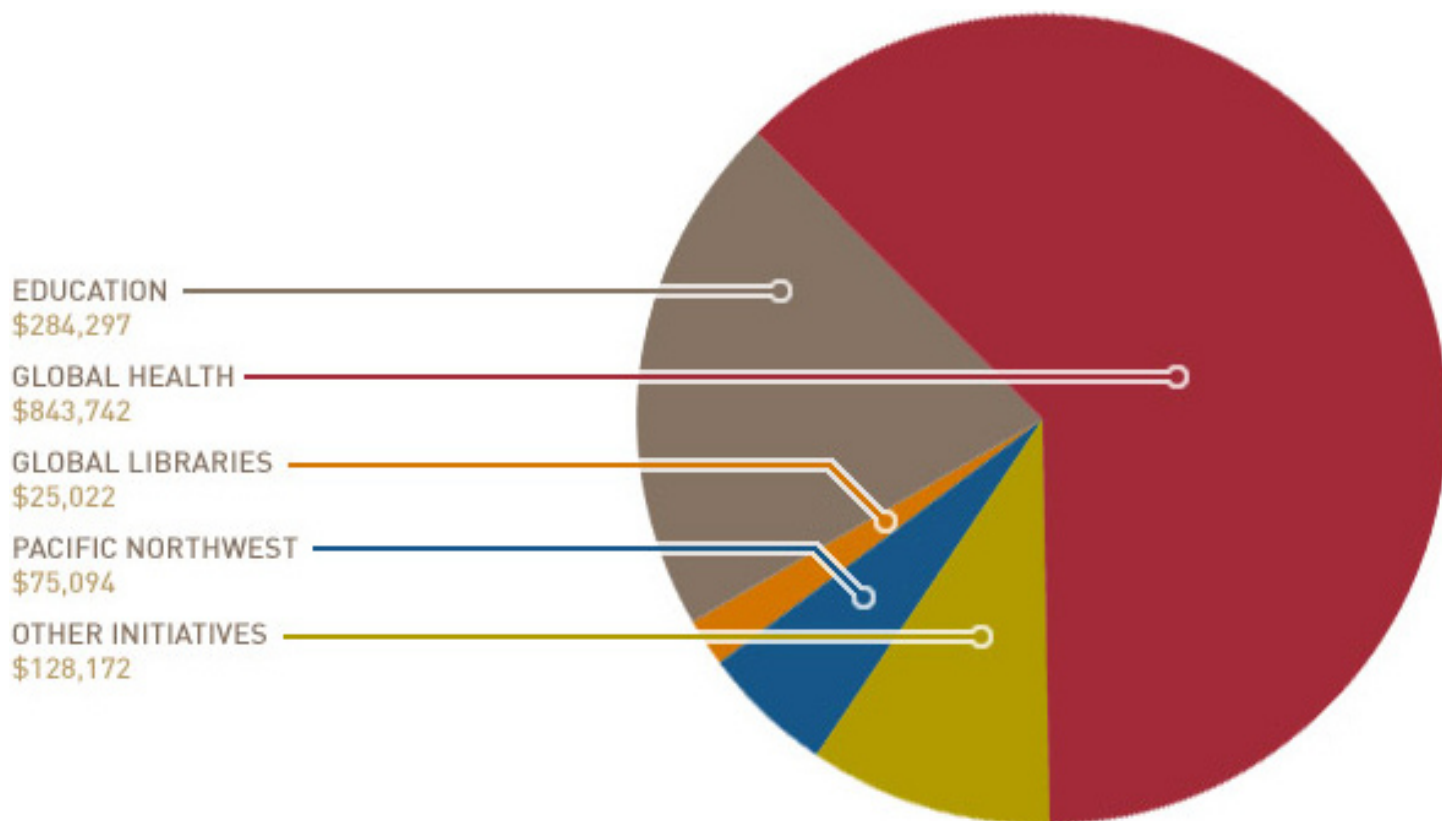
CONDENSED STATEMENTS OF ACTIVITIES

For the years ended December 31, 2005 and 2004 (Amounts in thousands)

CHANGE IN NET ASSETS:		2005		2004
REVENUES AND GAINS				
Contributions	\$	442,701	\$	711,453
Investment income, net		1,421,334		2,632,002
Total revenues and gains		1,864,035		3,343,455
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		1,711,608		1,580,473
Increase in net assets		152,427		1,762,982
Unrestricted net assets, beginning of year		26,854,289		25,091,307
Unrestricted net assets, end of year	\$	27,006,716	\$	26,854,289

GRANTS PAID

For the year ended December 31, 2005 (Amounts in thousands)



For the years ended December 31, 2005 and 2004 (Amounts in thousands)

PROGRAM AREAS		2005		2004
Education	\$	284,297	\$	708,425
Global Health		843,742		442,009
Global Libraries		25,022		24,869
Pacific Northwest		75,094		37,823
Other Initiatives		128,172		39,245
TOTAL GRANTS PAID	\$	1,356,327	\$	1,252,371

See the Management Discussion for an explanation of the increases and decreases in grants paid by each program from 2004 to 2005.

LEADERSHIP



Bill Gates
Co-Chair



Melinda Gates
Co-Chair



Bill Gates Sr.
Co-Chair



Patty Stonesifer
CEO

EXECUTIVE TEAM*

Sylvia M. Mathews
Chief Operating Officer and Executive Director

Allan C. Golston, C.P.A.
Chief Financial and Administrative Officer and Interim Executive Director, Global Health

Tom Vander Ark
Executive Director, Education

*In May 2006, we adopted a new organizational structure and announced three new presidents: Allan Golston (U.S. Program), Sylvia Mathews (Global Development Program), and Dr. Tadataka "Tachi" Yamada (Global Health Program). You can find more information on our new organization on our Web site.



From left to right: Sylvia Mathews, Dr. Tadataka "Tachi" Yamada, and Allan Golston