

Consolidated Financial Statements and
Report of Independent Certified Public
Accountants

The Welch Foundation

August 31, 2019 and 2018

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Board of Directors
The Robert A. Welch Foundation

Report on the financial statements

We have audited the accompanying consolidated financial statements of The Robert A. Welch Foundation and its limited partnership, the RWF Fund, LP, which comprise the consolidated statements of financial position as of August 31, 2019 and 2018, and the related consolidated statements of activities and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of the RWF Fund, LP, a limited partnership of which the Foundation is the sole limited partner which statements reflect total assets of 46% and 39% of total consolidated assets as of August 31, 2019 and 2018, respectively, total net assets of 34% and 41% of total consolidated net assets as of August 31, 2019 and 2018, respectively, and total revenues of 10% and 15% of total consolidated revenues, respectively, for the years then ended. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for the RWF Fund, LP, is based solely on the report of other auditors. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Foundation's preparation and fair presentation of the consolidated financial statements in order to design 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. Accordingly, we express no such opinion. An audit also includes evaluating the

appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, based on our audits and the report of other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of The Robert A. Welch Foundation and its limited partnership, the RWF Fund, LP, as of August 31, 2019 and 2018, and the changes in their net assets and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Grant Thornton LLP

Dallas, Texas
September 17, 2020

The Welch Foundation

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

As of August 31, 2019 and 2018

ASSETS	<u>2019</u>	<u>2018</u>
CASH AND CASH EQUIVALENTS	\$ 2,467,935	\$ 2,062,641
INVESTMENTS	703,185,799	722,085,624
RECEIVABLES:		
Investment transactions	385,062	387,203
Interest dividends	204,281	260,962
Other	<u>788,975</u>	<u>255,414</u>
Total receivables	<u>1,378,318</u>	<u>903,579</u>
OTHER ASSETS	<u>1,022,718</u>	<u>585,399</u>
Total	<u>\$ 708,054,770</u>	<u>\$ 725,637,243</u>
 LIABILITIES AND NET ASSETS		
LIABILITIES		
Unpaid grants	\$ 23,375,886	\$ 21,218,753
Current and deferred federal excise tax payable	1,499,273	2,730,346
Accounts payable and other	<u>182,339</u>	<u>372,191</u>
Total liabilities	<u>25,057,498</u>	<u>24,321,290</u>
NET ASSETS (DEFICIT):		
With donor restrictions	706,600,345	722,897,427
Without donor restrictions	<u>(23,603,073)</u>	<u>(21,581,474)</u>
Total net assets	<u>682,997,272</u>	<u>701,315,953</u>
Total	<u>\$ 708,054,770</u>	<u>\$ 725,637,243</u>

The accompanying notes are an integral part of these consolidated financial statements.

The Welch Foundation

CONSOLIDATED STATEMENT OF ACTIVITIES

For the year ended August 31, 2019

	2019		Total
	With Donor Restrictions	Without Donor Restrictions	
REVENUES, INCOME, AND GAINS (LOSSES)			
Interest and dividends	\$ 10,675	\$ 3,799,150	\$ 3,809,825
Oil and gas royalties and other	-	2,787,970	2,787,970
Net realized gains on sales of investments	63,335,646	-	63,335,646
Unrealized depreciation of investments	(47,113,066)	-	(47,113,066)
Unrealized appreciation of other assets	35,343	-	35,343
Investment management expenses	-	(3,447,071)	(3,447,071)
Federal excise tax provision	-	(759,224)	(759,224)
Total net investment income and gains	<u>16,268,598</u>	<u>2,380,825</u>	<u>18,649,423</u>
EXPENSES			
Grants approved, net	-	34,032,149	34,032,149
Grants administration	-	2,644,317	2,644,317
General and administrative	-	1,513,549	1,513,549
Total expenses	<u>-</u>	<u>38,190,015</u>	<u>38,190,015</u>
DEFERRED FEDERAL EXCISE TAX BENEFIT ON UNREALIZED CAPITAL GAINS	1,221,911	-	1,221,911
RESTRICTED TO UNRESTRICTED TRANSFER	(32,854,108)	32,854,108	-
ALLOCATION OF RESTRICTED TO UNRESTRICTED	(922,808)	922,808	-
SECTION 10 TRANSFER	<u>(10,675)</u>	<u>10,675</u>	<u>-</u>
CHANGE IN NET ASSETS	(16,297,082)	(2,021,599)	(18,318,681)
NET ASSETS (DEFICIT), beginning of year	<u>722,897,427</u>	<u>(21,581,474)</u>	<u>701,315,953</u>
NET ASSETS (DEFICIT), end of year	<u>\$ 706,600,345</u>	<u>\$ (23,603,073)</u>	<u>\$ 682,997,272</u>

The accompanying notes are an integral part of these consolidated financial statements.

The Welch Foundation

CONSOLIDATED STATEMENT OF ACTIVITIES

For the year ended August 31, 2018

	2018		Total
	With Donor Restrictions	Without Donor Restrictions	
REVENUES, INCOME, AND GAINS (LOSSES)			
Interest and dividends	\$ 8,874	\$ 3,345,720	\$ 3,354,594
Oil and gas royalties and other	-	1,800,546	1,800,546
Net realized gains on sales of investments	51,417,249	-	51,417,249
Unrealized appreciation of investments	20,734,606	-	20,734,606
Unrealized depreciation of other assets	(16,594)	-	(16,594)
Investment management expenses	-	(3,629,000)	(3,629,000)
Federal excise tax provision	-	(1,014,561)	(1,014,561)
Total net investment income and gains	<u>72,144,135</u>	<u>502,705</u>	<u>72,646,840</u>
EXPENSES			
Grants approved, net	-	30,965,002	30,965,002
Grants administration	-	2,525,298	2,525,298
General and administrative	-	1,700,884	1,700,884
Total expenses	<u>-</u>	<u>35,191,184</u>	<u>35,191,184</u>
CHANGE IN PENSION	-	334,995	334,995
DEFERRED FEDERAL EXCISE TAX PROVISION ON UNREALIZED CAPITAL GAINS	(525,140)	-	(525,140)
RESTRICTED TO UNRESTRICTED TRANSFER	(32,746,759)	32,746,759	-
ALLOCATION OF RESTRICTED TO UNRESTRICTED	<u>(1,335,859)</u>	<u>1,335,859</u>	<u>-</u>
CHANGE IN NET ASSETS	37,536,377	(270,866)	37,265,511
NET ASSETS (DEFICIT), beginning of year	<u>685,361,050</u>	<u>(21,310,608)</u>	<u>664,050,442</u>
NET ASSETS (DEFICIT), end of year	<u>\$ 722,897,427</u>	<u>\$ (21,581,474)</u>	<u>\$ 701,315,953</u>

The accompanying notes are an integral part of these consolidated financial statements.

The Welch Foundation

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended August 31, 2019 and 2018

	2019	2018
Cash flows from operating activities:		
Change in net assets	\$ (18,318,681)	\$ 37,265,511
Adjustments to reconcile change in net assets to net cash used in operating activities		
Amortization	(14,877)	(9,155)
Net realized gain on sales of investments	(63,335,646)	(51,417,249)
Unrealized depreciation (appreciation) of securities	47,113,066	(20,734,606)
Changes in operating assets and liabilities		
(Increase) decrease in receivables	(474,739)	191,774
Decrease (increase) in other assets	(437,319)	408,821
Increase in unpaid grants	2,157,133	1,172,003
(Decrease) increase in current and deferred federal excise taxes payable	(1,231,073)	534,302
(Decrease) in accounts payable and other	(189,852)	(940,446)
	<u>(34,731,988)</u>	<u>(33,529,045)</u>
Cash flows from investing activities:		
Purchases of investments	(213,684,150)	(148,521,002)
Proceeds from sales of investments	230,218,597	156,082,641
Return of capital	18,602,835	22,810,735
	<u>35,137,282</u>	<u>30,372,374</u>
Net cash provided by investing activities	<u>35,137,282</u>	<u>30,372,374</u>
Net increase (decrease) in cash and cash equivalents	405,294	(3,156,671)
Cash and cash equivalents, beginning of year	<u>2,062,641</u>	<u>5,219,312</u>
Cash and cash equivalents, end of year	<u>\$ 2,467,935</u>	<u>\$ 2,062,641</u>
Supplemental disclosures of cash flow information:		
Cash paid during the year for federal excise taxes	<u>\$ 1,170,000</u>	<u>\$ 610,000</u>

The accompanying notes are an integral part of these consolidated financial statements.

The Welch Foundation
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
August 31, 2019 and 2018

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Foundation

The Robert A. Welch Foundation (the "Foundation") is a private foundation created under the terms of the founder's will. The Foundation is a Texas nonprofit corporation and it is exempt from federal income taxation under Section 501(c)(3) of the Internal Revenue Code. The purpose of the Foundation is to receive and maintain real and personal property and to use, exclusively within the state of Texas, such income therefrom to assist research in the field of chemistry, with the discoveries and inventions made available to mankind.

Basis of Accounting

The accounts of the Foundation, which are maintained on the accrual basis of accounting, reflect investments at estimated fair value. Based on the Uniform Principal and Income Act of Texas, the Foundation allocates a percentage of the gross mineral revenue to the Principal Fund and will allocate a percentage of certain expenses to the Principal Fund.

Consolidation

The consolidated financial statements as of August 31, 2019 and 2018 include the accounts of the RWF Fund, LP (the "Partnership") in which the Foundation is the sole limited partner. The Partnership is a limited partnership which commenced on November 2, 2010 pursuant to the Revised Uniform Limited Partnership Act of the State of Delaware. All material intercompany transactions have been eliminated in consolidation.

Use of Estimates

Preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Net Asset Classification

Net assets and revenues, expenses, gains, and losses are classified based on the existence or absence of donor-imposed restrictions.

Net assets without donor restrictions – These net assets are not subject to donor-imposed stipulations.

Net assets with donor restrictions – Net assets with donor restrictions are net assets required to be maintained in perpetuity, with only the income to be used for the Foundation's activities, due to donor-imposed restrictions. The Foundation's assets are primarily maintained in permanently restricted net assets according to the last will and testament of Robert A. Welch.

Included in the net assets with donor restrictions is the Section 10 Fund. Under the Section 10 Fund, \$500,000 of the Foundation's original principal was set aside to be used for the purpose of extending financial aid to current and former employees of the Foundation or their families, in need. At each year end, any Section 10 net assets over \$500,000 in value are transferred to net assets without donor restrictions or maintained in net assets without donor restrictions as applicable.

The Welch Foundation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2019 and 2018

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

Except as required by the Internal Revenue Code Section 4942 ("IRC Section 4942") (which may require a distribution of principal), all distributions from the Foundation, other than distributions from the Section 10 Fund, shall be limited to the net income of the Foundation (determined on a cash basis), and shall include no part of the principal, which shall be kept intact and never expended, but used as the endowment fund of the Foundation.

In accordance with the last will of Robert A. Welch (the "Will"), for purposes of determining the amount of required distributions, the assets of the Foundation are accounted for as income and principal by application of the provisions of the Will and the Texas Trust Code and, consistent with the Texas Trust Code, consideration received on the sale or transfer of principal (i.e., realized capital gains and losses), is allocable to principal and, therefore, does not constitute income. Consequently, realized and unrealized gains and losses are considered permanently restricted by the Foundation.

To maintain its private foundation status, the IRC Section 4942 requires that 5% of the average assets, as defined by IRC Section 4942, are required to be distributed for its charitable purpose. As provided in the Bylaws of the Foundation, if income is insufficient to meet this requirement, principal may be used. Consequently, when required, a distribution is made from the Principal Fund to the Income Fund. During 2019 and 2018, \$32,854,108 and \$32,746,759, respectively, was transferred from the Principal Fund to the Income Fund.

Cash and Cash Equivalents

The Foundation considers all highly liquid financial instruments with an original maturity of 90 days or less, except those assigned to investment advisors, to be cash equivalents.

Other Assets

Other assets are principally comprised of property, plant and equipment, prepaid expenses, and the Section 10 Fund.

Unpaid Grants

Grants are recorded as an expense and a liability upon approval of the grants by the Foundation's Board of Directors. Such grants are presented net of grants returned of \$997,751 and \$688,834 and terminations of \$589,750 and \$694,750 for the years ended August 31, 2019 and 2018, respectively (see Note D).

Current Accounting Pronouncements

In 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2016-14, *Presentation of Financial Statements of Not-For-Profit Entities (ASU 2016-14)*. The Foundation adopted the provisions of this new standard during the year ended August 31, 2019. In addition to changes in terminology used to describe categories of net assets throughout the consolidated financial statements, new disclosures were added regarding liquidity and the availability of resources, and disclosures related to functional allocation of expenses.

The amendments in ASU 2016-14 have been adopted and applied by the Foundation on a retrospective bases for the year ended August 31, 2018.

The consolidated financial statements for the year ended August 31, 2018 have been restated to reflect the net asset classifications required by ASU 2016-14. Net assets classified previously as unrestricted are now reported as net assets without donor restrictions and temporarily or permanently restricted net assets are now reported as net assets with donor restrictions.

The Welch Foundation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2019 and 2018

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

Future Accounting Pronouncements

In June 2018, FASB issued ASU 2018-08, *Not for Profit Entities (Topic 958): Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. This standard clarifies and improves current guidance about whether a transfer of assets (or the reduction, settlement, or cancellation of liabilities) is a contribution or an exchange transaction. It is effective for annual financial statements issued for fiscal years beginning after December 15, 2019. The Foundation is currently evaluating the effects of this update on its consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13, *Changes to the Disclosure Requirements for Fair Value Measurement (Topic 820)*. This standard modifies the disclosure requirements on fair value measurements. ASU 2018-13 is effective for fiscal years beginning after December 15, 2019. The Foundation is evaluating the implications of ASU 2018-13 and its effects on the consolidated financial statements.

In February 2016, FASB issued ASU 2016-02, *Leases (Topic 842)*. The FASB issued the Update to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. This amendment is effective for fiscal years beginning after December 15, 2021. At this time, the Foundation is evaluating the implications of ASU 2016-02 and its effects on the consolidated financial statements.

NOTE B - INVESTMENTS

Investments are comprised of equities, alternative investments, fixed income and other investments. Equities and fixed income are reported at fair value, which is based on quoted market prices when available using the market approach. Realized and unrealized gains and losses on investments are computed by comparing cost, determined on an average cost per share basis, to sales proceeds and quoted market values, respectively.

Alternative investments are valued in accordance with fair value standards applicable to their asset class. For investments with limited marketability, including investments in some partnerships, the Foundation follows the accounting guidance related to the use of net asset value (“NAV”) as the practical expedient. Partnership investments are valued at fair value by the general partner in accordance with U.S. GAAP.

There are inherent limitations in any estimation technique. Because of the inherent uncertainty of valuation, the estimated fair value may differ significantly from the value that would have been used had a ready market for the investments existed, and the difference could be significant.

The Foundation had unfunded investment purchase commitments related to private equity funds of \$160,419,360 as of August 31, 2019 and \$137,358,764 as of August 31, 2018.

Other investments are comprised of mineral royalty and fee interests in oil and natural gas located in various states. These properties have a historical cost of \$3,111,782 at August 31, 2019 and 2018, and an equity investment in a limited partnership with a historical cost of \$176,667 at August 31, 2019 and 2018. The Foundation recorded an increase of \$425,126 and \$700,993 to these mineral and fee properties and the limited partnership investments in 2019 and 2018, respectively. Mineral and fee property investments are valued based on tax appraisals.

The Welch Foundation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2019 and 2018

NOTE B - INVESTMENTS - CONTINUED

The Foundation's investment policy seeks to preserve the capacity to fund grants both now and in the future. To this end, the basic objective is to seek maximum total return consistent with an acceptable level of risk, balancing the preservation of capital with the generation of returns sufficient to meet or exceed the sum of the Foundation's payout requirements, the rate of inflation and all costs associated with managing the Foundation's assets.

To satisfy these investment objectives, the Foundation's assets are invested in a diversified portfolio with an emphasis on equity investments.

Fair value, cost and cumulative unrealized gains (losses) on investments as of August 31, 2019 and 2018, were as follows:

	2019		
	Fair value	Cost	Cumulative unrealized gains
Domestic equity	\$ 143,362,054	\$ 136,567,492	\$ 6,794,562
International equity	123,378,536	87,603,788	35,774,748
Emerging market	49,635,587	46,065,266	3,570,321
Hedge fund	106,774,135	91,134,270	15,639,865
Private equity	212,352,205	172,498,013	39,854,192
Fixed income:			
Domestic	52,213,151	50,963,301	1,249,850
International	11,919,732	7,175,388	4,744,344
Other investments (primarily mineral and fee properties)	3,550,399	3,288,449	261,950
Total	\$ 703,185,799	\$ 595,295,967	\$ 107,889,832
	2018		
	Fair value	Cost	Cumulative unrealized gains (losses)
Domestic equity	\$169,970,282	\$123,523,273	\$46,447,009
International equity	125,623,060	77,210,158	48,412,902
Emerging market	41,288,338	36,299,779	4,988,559
Hedge fund	113,693,378	98,341,091	15,352,287
Private equity	185,942,515	148,926,522	37,015,993
Fixed income:			
Domestic	70,940,525	72,285,480	(1,344,955)
International	11,502,253	7,207,974	4,294,279
Other investments (primarily mineral and fee properties)	3,125,273	3,288,449	(163,176)
Total	\$722,085,624	\$567,082,726	\$155,002,898

The Welch Foundation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2019 and 2018

NOTE C - FAIR VALUE OF INVESTMENTS

The Foundation has estimated fair value of financial instruments in accordance with the fair value guidance. The Foundation's significant financial instruments consist of cash and cash equivalents, investments, receivables, other assets, unpaid grants, and other liabilities. The carrying amounts for cash and cash equivalents, receivables, other assets and other liabilities approximate fair value because of the short-term nature of these items. The fair value of investments is described in Note B.

Accounting Standards Codification ("ASC") 820, *Fair Value Measurements and Disclosures* establishes a fair value hierarchy that distinguishes between assumptions based on market data (observable inputs) and the Foundation's assumptions (unobservable inputs). Determining the level at which an asset or liability falls within the hierarchy requires significant judgment considering the lowest level input that is significant to the fair value measurement as a whole. The hierarchy consists of three broad levels, as follows, with Level 1 being the most observable:

Level 1 - Quoted market prices in active markets for identical assets or liabilities.

Level 2 - Quoted market prices in active or inactive markets for similar assets or liabilities and inputs other than quoted prices that are observable.

Level 3 - Unobservable inputs developed using the Foundation's and/or third-party estimates and assumptions, which reflect those that market participants would use.

The following tables presents information about the Foundation's long-term investments that are measured at fair value as of August 31, 2019 and 2018 and indicates the fair value hierarchy of the valuation techniques utilized to determine such fair value:

	2019			Total
	Level 1	Level 2	Level 3	
Domestic equity	\$ 59,954,104	\$ 19,051,924	\$ -	\$ 79,006,028
International equity	7,437,921	22,864,022	-	30,301,943
Emerging market	-	30,430,187	-	30,430,187
Private equity	-	-	212,285,065	212,285,065
Fixed income	38,723,969	-	-	38,723,969
Other investments (primarily mineral and fee properties)	-	-	3,550,399	3,550,399
Total	<u>\$ 106,115,994</u>	<u>\$ 72,346,133</u>	<u>\$ 215,835,464</u>	394,297,591
NAV investments				<u>308,888,208</u>
Total fair value				<u>\$ 703,185,799</u>

The Welch Foundation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2019 and 2018

NOTE C - FAIR VALUE OF INVESTMENTS - CONTINUED

	2018			Total
	Level 1	Level 2	Level 3	
Domestic equity	\$ 69,096,029	\$ 61,570,809	\$ -	\$ 130,666,838
International equity	7,923,898	24,396,155	-	32,320,053
Emerging market	-	20,058,956	-	20,058,956
Hedge fund	-	14,563,936	-	14,563,936
Private equity	-	-	185,751,975	185,751,975
Fixed income	43,610,997	-	-	43,610,997
Other investments (primarily mineral and fee properties)	-	-	3,125,273	3,125,273
Total	<u>\$ 120,630,924</u>	<u>\$ 120,589,856</u>	<u>\$ 188,877,248</u>	430,098,028
NAV investments				<u>291,987,596</u>
Total fair value				<u>\$ 722,085,624</u>

It is the policy of the Foundation to transfer investments between the levels of the fair value hierarchy if a change occurs within the underlying investment.

During the years ended August 31, 2019 and 2018, no investments were transferred between levels.

The following tables present additional information about assets that have been measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as of August 31, 2019 and 2018:

	2019				
	Beginning balance	Additions, contributions, subscriptions	Distributions, redemptions, transfers out	Unrealized gains	Ending balance
Private equity	\$ 185,751,975	\$ 42,616,763	\$ (18,867,319)	\$ 2,783,646	\$ 212,285,065
Other investments (primarily mineral and fee properties)	3,125,273	-	-	425,126	3,550,399
Total	<u>\$ 188,877,248</u>	<u>\$ 42,616,763</u>	<u>\$ (18,867,319)</u>	<u>\$ 3,208,772</u>	<u>\$ 215,835,464</u>

	2018				
	Beginning balance	Additions, contributions, subscriptions	Distributions, redemptions, transfers out	Unrealized gains	Ending balance
Private equity	\$ 150,969,540	\$ 40,872,037	\$ (20,503,317)	\$ 14,413,715	\$ 185,751,975
Other investments (primarily mineral and fee properties)	2,424,280	-	-	700,993	3,125,273
Total	<u>\$ 153,393,820</u>	<u>\$ 40,872,037</u>	<u>\$ (20,503,317)</u>	<u>\$ 15,114,708</u>	<u>\$ 188,877,248</u>

The Welch Foundation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2019 and 2018

NOTE C - FAIR VALUE OF INVESTMENTS - CONTINUED

The Foundation follows the accounting guidance related to the use of NAV as a practical expedient. As a result of applying the practical expedient, the Foundation's investment in certain investments was determined based on the NAV. The following table discloses investments valued at NAV:

	2019 Fair value	Redemption frequency	Redemption notice period	Unfunded commitment
Domestic equity (a)	\$ 64,356,026	Daily	1 day notice	none
International equity (b)	93,076,593	Monthly to annually	10 to 45 days notice	none
Emerging markets (c)	19,205,400	Monthly	6 days notice	none
Hedge fund (d)	106,774,135	Monthly to annually	5 to 90 days notice	none
Private equity (e)	67,140	None	no redemption ability	none
International fixed income (f)	11,919,732	Daily	10 days notice	none
Treasury inflation-protection security (g)	13,489,182	Daily	1 day notice	none
Total	<u>\$ 308,888,208</u>			
	2018 Fair value	Redemption frequency	Redemption notice period	Unfunded commitment
Domestic equity (a)	\$ 39,303,443	Daily	1 day notice	none
International equity (b)	93,303,007	Monthly	10 to 30 days notice	none
Emerging markets (c)	21,229,382	Monthly	6 days notice	none
Hedge fund (d)	99,129,443	Monthly to annually	5 to 90 days notice	none
Private equity (e)	190,541	None	no redemption ability	none
International fixed income (f)	11,502,253	Daily	10 days notice	none
Treasury inflation-protection security (g)	27,329,527	Daily	1 day notice	none
Total	<u>\$ 291,987,596</u>			

- (a) This is an investment in a fund that invests primarily in U.S. stocks in all market capitalization ranges.
- (b) This is an investment in funds that invests in equity securities of companies located in any country other than the U.S.
- (c) This is an investment in a fund seeking to achieve long term capital growth by investing in emerging markets.
- (d) This is an investment in hedge funds that aims to achieve a positive return on investment whether markets are rising or falling.
- (e) This is an investment in a fund that invests in global distressed assets.
- (f) This is an investment in a fund seeking to achieve interest income and long term capital appreciation in U.S. fixed income investments and non U.S. sovereign debt securities.
- (g) This is an investment in inflation protected U.S. government bonds.

NOTE D - UNPAID GRANTS

The Foundation's unpaid grants at August 31, 2019 represent commitments for grant disbursements approved but not paid of \$4,715,500 in 2020; \$14,671,500 in 2021; \$4,160,500 in 2022; \$175,000 in 2023, \$105,000 in 2024 and \$35,000 in 2025.

The Welch Foundation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2019 and 2018

NOTE D - UNPAID GRANTS - CONTINUED

The components of unpaid grants as of August 31, 2019 and 2018 were as follows:

	<u>2019</u>	<u>2018</u>
Unpaid grants - beginning of the year	\$ 21,218,753	\$ 20,046,750
Grants approved - net	34,518,763	31,574,999
Grants disbursed	<u>(31,875,016)</u>	<u>(29,791,249)</u>
Unpaid grants - end of year before discount	23,862,500	21,830,500
Less discount to reflect grants payable at present value	<u>(486,614)</u>	<u>(611,747)</u>
Unpaid grants - end of year	<u>\$ 23,375,886</u>	<u>\$ 21,218,753</u>

The unpaid grants primarily account for the net deficit in the Income Fund of \$23,603,073 and \$21,581,474 as of August 31, 2019 and 2018, respectively, as the grants are approved but not yet paid as of year end. Grant disbursements are made first from accumulated investment earnings and, if required to meet the minimum distribution requirements of IRC Section 4942, from the Principal Fund.

NOTE E - FEDERAL EXCISE TAX

The Foundation is classified as a private foundation as defined in IRC Section 4942. As a private foundation, the Foundation is subject to federal excise tax of 2% on net investment income. For the year end August 31, 2019, the Foundation qualified under IRC Section 4940(e) for a reduced rate of 1%. For the year ended August 31, 2018, the Foundation was subject to the 2% federal excise tax rate.

The Foundation is required to make certain qualifying distributions in order to maintain its private foundation status. Such required distributions have been or will be accomplished through the payment of grants and the operation of the Foundation's grant program. The components of the Foundation's federal excise tax provision for the years ended August 31, 2019 and 2018 were as follows:

	<u>2019</u>	<u>2018</u>
Federal excise tax provision on net investment income other than realized capital gains	\$ 57,669	\$ 218,396
Federal excise tax on realized capital gains	<u>701,555</u>	<u>796,165</u>
Current federal excise tax provision	759,224	1,014,561
Deferred federal excise tax (benefit) provision on unrealized capital gains	<u>(1,221,911)</u>	<u>525,140</u>
Total federal excise tax (benefit) expense	<u>\$ (462,687)</u>	<u>\$ 1,539,701</u>

The Welch Foundation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2019 and 2018

NOTE E - FEDERAL EXCISE TAX - CONTINUED

The Foundation provides deferred taxes for temporary differences in the recognition of gains and losses for tax and financial reporting purposes. The components of federal excise tax payable as of August 31, 2019 and 2018 were as follows:

	<u>2019</u>	<u>2018</u>
Current and deferred federal tax excise payable	<u>\$ 1,499,273</u>	<u>\$ 2,730,346</u>

NOTE F - RELATED PARTY TRANSACTIONS

There were no related-party transactions during the year ended August 31, 2019 or 2018.

NOTE G - EMPLOYEE BENEFIT PLANS

The Foundation sponsored The Robert A. Welch Foundation Defined Benefit Retirement Plan (the "Plan"), a noncontributory defined benefit plan. All employees of the Foundation were eligible to participate at their date of employment.

As of December 31, 2015 and March 31, 2016, the Foundation curtailed ("froze") and then terminated the Plan, respectively. As a result, no further accumulation of pension benefits for service by those employees occurred after curtailment. An application for favorable determination upon plan termination was filed and accepted by the Internal Revenue Service.

All assets were distributed from the Plan in 2018.

The change in benefit obligation, plan obligation, change in plan assets, reconciliation of funded status, and net periodic pension cost of the Plan for August 31, 2018 is as follows:

	<u>2018</u>
Change in benefit obligation:	
Projected benefit obligation - beginning of year	\$ 6,426,060
Interest cost	37,542
Actuarial loss	(38)
Benefits paid	(15,424)
Settlement	<u>(6,448,140)</u>
Projected benefit obligation - end of year	<u>\$ -</u>
Change in plan assets:	
Fair value of plan assets - beginning of year	\$ 6,091,065
Actual return on plan assets	16,134
Employer contribution	379,469
Settlement	<u>(6,486,668)</u>
Fair value of plan assets - end of year	<u>\$ -</u>
Funded status - reported in other assets	<u>\$ -</u>

The Welch Foundation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2019 and 2018

NOTE G - EMPLOYEE BENEFIT PLANS - CONTINUED

	2018
Net periodic pension cost:	
Interest cost	\$ 37,542
Expected return on plan assets	(7,144)
Amortization of net loss	14,770
Settlement	728,864
	<hr/>
Net periodic pension cost	\$ 774,032

Asset Allocation

Due to the termination of the Plan, all of the Plan's assets have been distributed.

Contributions

The Foundation contributed \$379,469 to the Plan in 2018.

Employees are also eligible to participate in the Thrift Plan of The Robert A. Welch Foundation under which all employees may contribute between 3% and 10% of defined compensation. The Foundation makes matching contributions in an amount equal to 100% of the amount of before-tax contributions made on the employees' behalf that were not in excess of 3% of their compensation plus 50% of the amounts that were between 3% and 6% of employee compensation. The Foundation contributes 12% to the employee's plans. The Foundation made contributions of \$162,111 and \$166,054 to the Thrift Plan in 2019 and 2018, respectively.

NOTE H - COMMITMENTS AND CONTINGENCIES

The Foundation leases office space under a 10-year operating lease. Under the lease, annual minimum base rentals are approximately \$346,000 as of August 31, 2019 and are subject to annual 2.5% increases through the term of the lease which expires on February 28, 2026. The lease contains two five-year renewal options or one ten-year renewal option. Base rental and operating expenses for the years ended August 31, 2019 and 2018 were approximately \$540,000 and \$513,000, respectively.

NOTE I - FUNCTIONAL EXPENSES

Functional expenses present expenses by function and natural classification. Costs are allocated between grant related expenses and expenses related to management and general costs. Those expenses include payroll and employee costs, board and professional fees, occupancy and other operating costs. Payroll and employee costs are allocated based on estimates of time and effort. Board and professional fees are allocated based on the services provided. Occupancy costs are allocated based on square footage. Other operating costs are allocated based on time and effort, the nature of the specific expenditure, and square footage.

The Welch Foundation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2019 and 2018

NOTE I - FUNCTIONAL EXPENSES – CONTINUED

The following is a functional classification of the Foundation's expenses:

	2019			
	Grants approved, net	Grant administration	General and administrative	Total
Grants approved, net	\$ 34,032,149	\$ -	\$ -	\$ 34,032,149
Payroll and employee costs	-	935,698	940,061	1,875,759
Board and professional fees	-	1,107,193	182,896	1,290,089
Occupancy	-	312,704	227,279	539,983
Other operating costs	-	288,722	163,313	452,035
	<u>\$ 34,032,149</u>	<u>\$ 2,644,317</u>	<u>\$ 1,513,549</u>	<u>\$ 38,190,015</u>

NOTE J - LIQUIDITY AND AVAILABILITY OF RESOURCES

The Foundation's financial assets available within one year of the consolidated statements of financial position date for general expenditure are as follows:

	2019	2018
Cash and cash equivalents	\$ 2,467,935	\$ 2,062,641
Liquid investments (excludes private equity and other investments)	487,283,195	533,017,834
Receivables and other investments	1,378,318	903,579
Financial assets available for general expenditures within one year	491,129,448	535,984,054
Amounts unavailable to management without Board's approval	(487,283,195)	(533,017,834)
Total financial assets available to management within one year	<u>\$ 3,846,253</u>	<u>\$ 2,966,220</u>

As part of the Foundation's liquidity management, it maintains a policy of structuring its financial assets to be available as its general expenditures, liabilities, and other obligations come due.

NOTE K - SUBSEQUENT EVENTS

In January 2020, with the outbreak of Covid-19, the global equity markets have experienced significant volatility. Governments and central banks have reacted with monetary interventions designed to stabilize economic conditions. While the disruption is currently expected to be temporary there is uncertainty around the extent and duration. Therefore, while the Foundation expects this matter to have an impact on its results as a result of the stock market volatility, the related financial impact cannot be reasonably estimated at this time.

Effective July 30, 2020, the Board approved a ten year, \$100,000,000 grant. The first payment was made in August, 2020 and payments are to be made through July, 2030.

The Welch Foundation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2019 and 2018

The Foundation evaluated all events or transactions that occurred after August 31, 2019, up through September 17, 2020, the date the consolidated financial statements were available to be issued. During this period, the Foundation did not have any additional subsequent events which would require recognition or disclosure in the consolidated financial statements.