

Consolidated Financial Statements and Report of  
Independent Certified Public Accountants

**The Welch Foundation**

August 31, 2015 and 2014

# Contents

	<u>Page</u>
Report of Independent Certified Public Accountants	3
Consolidated Statements of Financial Position	5
Consolidated Statements of Activities	6
Consolidated Statements of Cash Flows	8
Notes to Consolidated Financial Statements	9



# Grant Thornton

Grant Thornton LLP  
700 Milam Street, Suite 300  
Houston, TX 77002-2848

T 832.476.3600  
F 713.655.8741  
GrantThornton.com  
[linkd.in/GrantThorntonUS](https://www.linkedin.com/company/grantthorntonus)  
[twitter.com/GrantThorntonUS](https://twitter.com/GrantThorntonUS)

## REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Board of Directors  
The Robert A. Welch Foundation

We have audited the accompanying consolidated financial statements of The Robert A. Welch Foundation and its limited partnership, RWF Fund, LP (collectively referred to as the “Foundation”), which comprise the consolidated statements of financial position as of August 31, 2015 and 2014, and the related consolidated statements of activities, and cash flows for the years then ended, and the related notes to the 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 27% and 22% of total consolidated assets as of August 31, 2015 and 2014, respectively, total net assets of 28% and 23% of total consolidated net assets as of August 31, 2015 and 2014, respectively, and total revenues of 5% and 6% 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 in our opinion, insofar as it relates to the amounts included for the RWF, Fund, LP is based solely on the report of the 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 entity'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 entity'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 limited partnership as of August 31, 2015 and 2014, and the results of their operations 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*

Houston, Texas  
May 25, 2016

**The Welch Foundation**

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION  
As of August 31, 2015 and 2014

	2015	2014
<b>ASSETS</b>		
CASH AND CASH EQUIVALENTS	\$ 1,788,185	\$ 1,242,412
INVESTMENTS	637,794,514	694,405,266
RECEIVABLES:		
Investment transactions	1,982,134	1,836,131
Interest and dividends	435,189	465,335
Other	280,436	389,328
Total receivables	2,697,759	2,690,794
OTHER ASSETS	909,582	1,577,670
<b>TOTAL</b>	<b>\$ 643,190,040</b>	<b>\$ 699,916,142</b>
<b>LIABILITIES AND NET ASSETS</b>		
LIABILITIES:		
Unpaid grants	\$ 20,726,250	\$ 22,562,250
Deferred federal excise tax payable	1,138,261	2,583,949
Accounts payable and other	553,426	551,114
Investment transactions payable	1,779,324	792,465
Total liabilities	24,197,261	26,489,778
<b>COMMITMENTS AND CONTINGENCIES</b>		
NET ASSETS (DEFICIT):		
Permanently restricted - principal fund	639,735,026	695,361,705
Unrestricted deficit - income fund	(21,242,247)	(22,434,699)
Temporarily restricted - Section 10 fund	500,000	499,358
Total net assets	618,992,779	673,426,364
<b>TOTAL</b>	<b>\$ 643,190,040</b>	<b>\$ 699,916,142</b>

The accompanying notes are an integral part of these statements.

## The Welch Foundation

### CONSOLIDATED STATEMENT OF ACTIVITIES For the year ended August 31, 2015

	2015			Total
	Permanently Restricted - Principal Fund	Unrestricted Deficit - Income Fund	Temporarily Restricted - Section 10 Fund	
<b>REVENUES:</b>				
Interest	\$ -	\$ 1,393,596	\$ 6,569	\$ 1,400,165
Dividends	-	3,669,455	-	3,669,455
Oil and gas royalties and other	-	1,964,865	-	1,964,865
Total revenues	-	7,027,916	6,569	7,034,485
<b>EXPENSES:</b>				
Investment advisory and custodial fees	-	3,689,960	-	3,689,960
General and administrative	-	2,808,631	-	2,808,631
Federal excise tax provision on net investment income	-	94,375	-	94,375
Property and production taxes	-	166,651	-	166,651
Advisory board fees and expenses	-	501,667	-	501,667
Total expenses	-	7,261,284	-	7,261,284
GRANTS APPROVED - Net	-	(28,722,825)	-	(28,722,825)
<b>NET REALIZED GAINS ON SALES OF INVESTMENTS AND OTHER ASSETS</b>				
	40,498,557	-	1,580	40,500,137
<b>UNREALIZED (DEPRECIATION) APPRECIATION OF INVESTMENTS</b>				
	(66,452,469)	-	1,940	(66,450,529)
DECREASE IN PREPAID PENSION COST	-	(604,867)	-	(604,867)
FEDERAL EXCISE TAX ON REALIZED CAPITAL GAINS	(374,390)	-	-	(374,390)
DEFERRED FEDERAL EXCISE TAX BENEFIT ON UNREALIZED CAPITAL GAINS	1,445,688	-	-	1,445,688
PRINCIPAL TO INCOME TRANSFER	(29,317,327)	29,317,327	-	-
ALLOCATION OF PRINCIPAL TO INCOME	(1,429,616)	1,429,616	-	-
SECTION 10 TRANSFER	2,878	6,569	(9,447)	-
CHANGE IN NET ASSETS	(55,626,679)	1,192,452	642	(54,433,585)
NET ASSETS (DEFICIT), beginning of year	695,361,705	(22,434,699)	499,358	673,426,364
NET ASSETS (DEFICIT), end of year	\$ 639,735,026	\$ (21,242,247)	\$ 500,000	\$ 618,992,779

The accompanying notes are an integral part of these statements.

## The Welch Foundation

### CONSOLIDATED STATEMENT OF ACTIVITIES

For the year ended August 31, 2014

	2014			Total
	Permanently Restricted - Principal Fund	Unrestricted Deficit - Income Fund	Temporarily Restricted - Section 10 Fund	
<b>REVENUES:</b>				
Interest	\$ -	\$ 1,743,092	\$ 5,855	\$ 1,748,947
Dividends	-	4,561,036	-	4,561,036
Oil and gas royalties and other	-	3,308,839	-	3,308,839
Total revenues	-	9,612,967	5,855	9,618,822
<b>EXPENSES:</b>				
Investment advisory and custodial fees	-	3,343,513	-	3,343,513
General and administrative	-	2,694,555	-	2,694,555
Federal excise tax provision on net investment income	-	104,232	-	104,232
Property and production taxes	-	209,845	-	209,845
Advisory board fees and expenses	-	460,000	-	460,000
Total expenses	-	6,812,145	-	6,812,145
GRANTS APPROVED - Net	-	(34,194,525)	-	(34,194,525)
<b>NET REALIZED GAINS ON SALES OF INVESTMENTS AND OTHER ASSETS</b>				
	28,214,955	-	4,918	28,219,873
<b>UNREALIZED APPRECIATION OF INVESTMENTS</b>				
	66,702,932	-	4,526	66,707,458
INCREASE IN PREPAID PENSION COST	-	103,807	-	103,807
FEDERAL EXCISE TAX ON REALIZED CAPITAL GAINS	(644,477)	-	-	(644,477)
DEFERRED FEDERAL EXCISE TAX PROVISION ON UNREALIZED CAPITAL GAINS	(1,172,288)	-	-	(1,172,288)
PRINCIPAL TO INCOME TRANSFER	(24,446,259)	24,446,259	-	-
ALLOCATION OF PRINCIPAL TO INCOME	(854,782)	854,782	-	-
CHANGE IN NET ASSETS	67,800,081	(5,988,855)	15,299	61,826,525
NET ASSETS (DEFICIT), beginning of year	627,561,624	(16,445,844)	484,059	611,599,839
NET ASSETS (DEFICIT), end of year	\$ 695,361,705	\$ (22,434,699)	\$ 499,358	\$ 673,426,364

The accompanying notes are an integral part of these statements.

**The Welch Foundation**

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended August 31, 2015 and 2014

	2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES:		
Change in net assets	\$ (54,433,585)	\$ 61,826,525
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Depreciation and amortization	226,772	244,848
Decrease (increase) in prepaid pension cost	604,867	(103,807)
Net realized gain on sales of investments	(40,500,137)	(28,219,873)
Unrealized depreciation (appreciation) of investments	66,450,529	(66,707,458)
Changes in operating assets and liabilities:		
Increase in receivables	(6,965)	(1,060,938)
Decrease (increase) in other assets	59,635	(136,959)
(Decrease) increase in unpaid grants	(1,836,000)	5,868,000
(Decrease) increase in deferred federal excise taxes payable	(1,445,688)	1,172,288
Increase in accounts payable and other	2,312	291,464
Increase in investment transactions payable	986,859	744,822
Net cash used in operating activities	(29,891,401)	(26,081,088)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of investments	(113,434,148)	(173,555,133)
Proceeds from sales of investments	135,795,907	189,064,072
Return of capital	8,075,415	9,351,906
Net cash provided by investing activities	30,437,174	24,860,845
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	545,773	(1,220,243)
CASH AND CASH EQUIVALENTS, beginning of year	1,242,412	2,462,655
CASH AND CASH EQUIVALENTS, end of year	\$ 1,788,185	\$ 1,242,412
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the year for federal excise taxes	\$ 415,000	\$ 865,000

The accompanying notes are an integral part of these statements.



## The Welch Foundation

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS As of and for the years ended August 31, 2015 and 2014

#### NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

##### 1. 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.

##### 2. Basis of Accounting

The accounts of the Foundation, which are maintained on the accrual basis of accounting, reflect investments at estimated fair market 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.

##### 3. Consolidation

The consolidated financial statements as of August 31, 2015 and 2014 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.

##### 4. Use of Estimates

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

##### 5. Net Asset Classification

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

*Unrestricted Net Deficit* – Unrestricted net deficit is not subject to donor-imposed stipulations. The Foundation classifies its Income Fund as unrestricted.

*Temporarily Restricted Net Assets* – Temporarily restricted net assets are subject to donor-imposed stipulations that require the passage of time or the occurrence of a specific event. The Foundation classifies its Section 10 Fund as temporarily restricted.

## The Welch Foundation

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED As of and for the years ended August 31, 2015 and 2014

#### NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

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 the Income Fund or Principal Fund, as applicable, of the Foundation.

*Permanently Restricted Net Assets* - Permanently restricted net assets are 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 of the Principal Fund, according to the last will and testament of Robert A. Welch.

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 2015 and 2014, \$29,317,327 and \$24,446,259, respectively, was transferred from the Principal Fund to the Income Fund.

#### 6. 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.

#### 7. Other Assets

Other assets are principally comprised of prepaid pension costs (see Note G), property, plant and equipment, and the Section 10 Fund.

#### 8. 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 \$333,458 and \$293,393 and terminations of \$1,011,336 and \$605,250 for the years ended August 31, 2015 and 2014, respectively (see Note D).

## The Welch Foundation

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED As of and for the years ended August 31, 2015 and 2014

#### NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

##### 9. Future Accounting Pronouncements

In May 2015, FASB issued ASU 2015-07, “*Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent) - a consensus of the FASB Emerging Issues Task Force (ASC 820, Fair Value Measurement)*”. The amendments in this Update remove the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share practical expedient. The amendments also remove the requirement to make certain disclosures for all investments that are eligible to be measured at fair value using the net asset value per share practical expedient. Rather, those disclosures are limited to investments for which the entity has elected to measure the fair value using that practical expedient. The provisions in this amendment are effective for fiscal years beginning after December 15, 2016 for private companies. The Foundation anticipates adopting the amendment in fiscal year 2017.

#### NOTE B – INVESTMENTS

Investments, as of August 31, 2015 and 2014, 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 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 \$97,943,914 as of August 31, 2015 and \$86,148,243 as of August 31, 2014.

Other investments are presented at estimated fair market value and are comprised of mineral and fee properties with a historical cost of \$ 3,111,782 as of August 31, 2015 and \$3,116,393 as of August 31, 2014, and an equity investment in a limited partnership with a historical cost of \$176,667 at August 31, 2015 and 2014. The Foundation recorded an increase of \$77,942 and recorded a decrease of (\$346,378) to these mineral and fee property and the limited partnership investments in 2015 and 2014, respectively. Mineral and fee property investments are valued based on tax appraisals.

## The Welch Foundation

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED As of and for the years ended August 31, 2015 and 2014

#### 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, 2015 and 2014, were as follows:

	2015		Cumulative unrealized gains (losses)
	Fair value	Cost	
Domestic equity	\$ 157,028,712	\$ 118,248,357	\$ 38,780,355
International equity	145,335,142	112,569,378	32,765,764
Emerging market	38,846,631	47,089,316	(8,242,685)
Hedge fund	82,176,939	74,699,269	7,477,670
Private equity	108,120,480	83,097,254	25,023,226
Inflation hedging	26,347,984	39,191,450	(12,843,466)
Fixed income:			
Domestic	53,836,527	52,549,660	1,286,867
International	20,001,561	13,756,148	6,245,413
Other investments (primarily mineral and fee properties)	6,100,538	3,288,449	2,812,089
<b>Total</b>	<b>\$ 637,794,514</b>	<b>\$ 544,489,281</b>	<b>\$ 93,305,233</b>

## The Welch Foundation

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED As of and for the years ended August 31, 2015 and 2014

#### NOTE B – INVESTMENTS – Continued

	2014		Cumulative unrealized gains (losses)
	Fair value	Cost	
Domestic equity	\$ 175,537,582	\$ 116,713,317	\$ 58,824,265
International equity	172,561,111	119,100,488	53,460,623
Emerging market	48,805,760	47,400,000	1,405,760
Hedge fund	83,565,585	72,467,161	11,098,424
Private equity	79,057,136	58,190,656	20,866,480
Inflation hedging	36,331,654	38,708,058	(2,376,404)
Fixed income:			
Domestic	59,851,276	58,165,088	1,686,188
International	32,672,566	20,609,736	12,062,830
Other investments (primarily mineral and fee properties)	6,022,596	3,293,060	2,729,536
Total	<u>\$ 694,405,266</u>	<u>\$ 534,647,564</u>	<u>\$ 159,757,702</u>

#### 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 federal excise tax payable. The carrying amounts for cash and cash equivalents, receivables, other assets, unpaid grants 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.

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 Welch Foundation**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED  
As of and for the years ended August 31, 2015 and 2014

**NOTE C – FAIR VALUE OF INVESTMENTS – Continued**

The following tables presents information about the Foundation’s long-term investments that are measured at fair value as of August 31, 2015 and August 31, 2014 and indicates the fair value hierarchy of the valuation techniques utilized to determine such fair value:

	2015			Total
	Level 1	Level 2	Level 3	
Domestic equity	\$ 131,048,904	\$ 25,979,808	\$ -	\$ 157,028,712
International equity	40,890,476	104,444,666	-	145,335,142
Emerging market	-	38,846,631	-	38,846,631
Hedge fund	-	15,793,143	66,383,796	82,176,939
Private equity	-	-	108,120,480	108,120,480
Inflation hedging	-	26,347,984	-	26,347,984
Fixed income:				
Domestic	53,836,527	-	-	53,836,527
International	-	20,001,561	-	20,001,561
Other investments (primarily mineral and fee properties)	-	-	6,100,538	6,100,538
<b>Total</b>	<b>\$ 225,775,907</b>	<b>\$ 231,413,793</b>	<b>\$ 180,604,814</b>	<b>\$ 637,794,514</b>

  

	2014			Total
	Level 1	Level 2	Level 3	
Domestic equity	\$ 135,974,330	\$ 39,563,252	\$ -	\$ 175,537,582
International equity	71,135,208	101,425,903	-	172,561,111
Emerging market	-	48,805,760	-	48,805,760
Hedge fund	-	9,500,000	74,065,585	83,565,585
Private equity	-	-	79,057,136	79,057,136
Inflation hedging	-	36,331,654	-	36,331,654
Fixed income:				
Domestic	59,851,276	-	-	59,851,276
International	-	32,672,566	-	32,672,566
Other investments (primarily mineral and fee properties)	-	-	6,022,596	6,022,596
<b>Total</b>	<b>\$ 266,960,814</b>	<b>\$ 268,299,135</b>	<b>\$ 159,145,317</b>	<b>\$ 694,405,266</b>

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, 2015 and 2014 no investments were transferred between levels.

**The Welch Foundation**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

As of and for the years ended August 31, 2015 and 2014

**NOTE C – FAIR VALUE OF INVESTMENTS – Continued**

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, 2015 and August 31, 2014:

	2015				
	Beginning balance	Additions, contributions, subscriptions	Distributions, redemptions, transfers out	Unrealized gains	Ending balance
Hedge fund	\$ 74,065,585	\$ 5,000,000	\$ (8,267,893)	\$ (4,413,896)	\$ 66,383,796
Private equity	79,057,136	32,982,835	(8,076,237)	4,156,746	108,120,480
Other investments (primarily mineral and fee properties)	6,022,596	-	(4,611)	82,553	6,100,538
<b>Total</b>	<b>\$ 159,145,317</b>	<b>\$ 37,982,835</b>	<b>\$ (16,348,741)</b>	<b>\$ (174,597)</b>	<b>\$ 180,604,814</b>

  

	2014				
	Beginning balance	Additions, contributions, subscriptions	Distributions, redemptions, transfers out	Unrealized gains	Ending balance
Hedge fund	\$ 106,548,258	\$ -	\$ (34,408,250)	\$ 1,925,577	\$ 74,065,585
Private equity	56,281,950	24,426,422	(9,354,555)	7,703,319	79,057,136
Other investments (primarily mineral and fee properties)	6,368,974	-	-	(346,378)	6,022,596
<b>Total</b>	<b>\$ 169,199,182</b>	<b>\$ 24,426,422</b>	<b>\$ (43,762,805)</b>	<b>\$ 9,282,518</b>	<b>\$ 159,145,317</b>

The Foundation follows the accounting guidance related to the use of Net Asset Value (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 Net Asset Value:

	2015 Fair value	Redemption frequency	Redemption notice period	Unfunded commitment
Domestic equity (a)	\$ 25,979,808	Daily	1 day notice	none
International equity (b)	116,790,351	Daily to monthly	1 to 6 days notice	none
Emerging markets (c)	20,910,415	Monthly	6 days notice	none
Hedge fund (d)	66,383,796	Monthly to annually	33 to 90 days notice	none
Inflation hedging (e)	26,347,984	Monthly	40 days notice	none
Private equity (f)	3,048,437	None	no redemption ability	none
Fixed income:				
International fixed income (g)	20,001,561	Daily	10 days notice	none
<b>Total</b>	<b>\$ 279,462,352</b>			

**The Welch Foundation**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED  
As of and for the years ended August 31, 2015 and 2014

**NOTE C – FAIR VALUE OF INVESTMENTS – Continued**

- (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 seeks to perform well in rising inflation environments.
- (f) This is an investment in a fund that invests in global distressed assets.
- (g) 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.

**NOTE D – UNPAID GRANTS**

The Foundation's unpaid grants at August 31, 2015, represent commitments for grant disbursements approved but not paid of \$5,495,500 in 2016; \$11,504,250 in 2017; \$3,691,500 in 2018, and \$35,000 in 2019.

The components of unpaid grants as of August 31, 2015 and 2014 were as follows:

	2015	2014
Unpaid grants - beginning of the year	\$ 22,562,250	\$ 16,694,250
Grants approved - net	28,722,825	34,194,525
Grants disbursed	(30,558,825)	(28,326,525)
Unpaid grants - end of year	\$ 20,726,250	\$ 22,562,250

The unpaid grants primarily account for the net deficit in the Income Fund of \$21,242,247 and \$22,434,699 as of August 31, 2015 and 2014, 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 ended August 31, 2015 the Foundation qualified under IRC Section 4940(e) for a reduced excise tax rate of 1%.



**The Welch Foundation**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

As of and for the years ended August 31, 2015 and 2014

**NOTE E – FEDERAL EXCISE TAX – Continued**

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, 2015 and 2014 were as follows:

	2015	2014
Federal excise tax provision on net investment income other than realized capital gains	\$ 94,375	\$ 104,232
Federal excise tax on realized capital gains	374,390	644,477
Current federal excise tax provision	468,765	748,709
Deferred federal excise tax (benefit) provision on unrealized capital gains	(1,445,688)	1,172,288
Total federal excise tax	\$ (976,923)	\$ 1,920,997

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, 2015 and 2014 were as follows:

	2015	2014
Deferred tax excise payable	\$ 1,138,261	\$ 2,583,949

**NOTE F – RELATED PARTY TRANSACTIONS**

There were no related-party transactions during the year ended August 31, 2015.

**NOTE G – EMPLOYEE BENEFIT PLANS**

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

**The Welch Foundation**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED  
As of and for the years ended August 31, 2015 and 2014

**NOTE G – EMPLOYEE BENEFIT PLANS – Continued**

The change in benefit obligation, plan obligation, change in plan assets, reconciliation of funded status and net periodic pension cost of the Plan, along with the actuarial assumptions used to determine these amounts for the years ended August 31, 2015 and 2014 are as follows:

	2015	2014
Change in benefit obligation:		
Projected benefit obligation - beginning of year	\$ 5,359,713	\$ 4,637,859
Service cost	147,330	138,931
Interest cost	198,403	207,645
Actuarial loss	110,910	399,751
Benefits paid	(23,835)	(24,473)
Projected benefit obligation - end of year	\$ 5,792,521	\$ 5,359,713
Change in plan assets:		
Fair value of plan assets - beginning of year	\$ 6,112,922	\$ 5,287,261
Actual return on plan assets	(148,224)	850,134
Benefits paid	(23,835)	(24,473)
Fair value of plan assets - end of year	\$ 5,940,863	\$ 6,112,922
Funded status - reported in other assets	\$ 148,342	\$ 753,209

The Foundation recognized a decrease in prepaid pension cost of (\$604,867) for 2015 and an increase in prepaid pension cost of \$103,807 for 2014.

	2015	2014
Net periodic pension cost:		
Service cost	\$ 147,330	\$ 138,931
Interest cost	198,403	207,645
Expected return on plan assets	(411,818)	(382,365)
Amortization of net loss	22,828	48,853
Net periodic pension cost	\$ (43,257)	\$ 13,064

The accumulated benefit obligation for the defined benefit plan for the years ending August 31, 2015 and 2014 was \$5,411,197 and \$4,823,459, respectively.

## The Welch Foundation

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED As of and for the years ended August 31, 2015 and 2014

#### NOTE G – EMPLOYEE BENEFIT PLANS – Continued

##### 1. Asset Allocation

The asset allocation as of the most recent statement date available for fiscal year 2015 was as follows:

	<u>Current allocation</u>
Cash	8%
Domestic fixed income	30%
Domestic equity	36%
International equity	25%
Other	1%
	<u>100%</u>

The total value of the assets was \$5,940,863 and estimated return from investment income and unrealized gains was approximately (2.4)% in fiscal year 2015. In fiscal year 2014, the total value of the assets was \$6,112,922 and estimated return from investment income and unrealized gains was approximately 16.1%.

##### 2. Investment Strategy

The Foundation's investment strategy for the Plan is to invest in equities and fixed income for long-term growth and to maintain liquidity satisfactory to meet short-term obligations. The target allocations range is as follows:

	<u>Target allocations limits</u>
Asset category:	
Cash	0 - 10%
Domestic fixed income	20 - 45%
International fixed income	0 - 10%
Domestic equity	35 - 50%
International equity	20 - 50%

##### 3. Contributions

Based on a historical review of the prior year's contributions, the Foundation did not plan to contribute to the Plan in fiscal year 2016. Contributions will vary as a result of demographics of the population, investment performance, actuarial assumptions and mix of the investments. The estimate is periodically reviewed and updated during the fiscal year. No contributions were made in the years ended August 31, 2015 and 2014.

The Welch Foundation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED  
As of and for the years ended August 31, 2015 and 2014

NOTE G – EMPLOYEE BENEFIT PLANS – Continued

4. Rate of Return and Discount Rate

Based on a review of actuarial assumptions, as well as historical rates of return on plan assets' existing long-term interest rates, the long-term expected rate of return on plan assets was 6.75% (2014: 7.25%). The discount rate used for the calculation of the net periodic benefit cost at the beginning of the year was 3.71% (2014: 4.49%), and the discount rate used for year-end measurements was 4.15% (2014: 3.71%), for the Plan. In determining the pension balance, management considered salary growth rates of 3% (2014: 3%).

The Plan made benefit payments of \$21,287 and 24,473 for Plan years ended December 31, 2015 and December 31, 2014, respectively.

5. Estimated Future Benefit Payments

The following estimated benefit payments, which reflect expected future service, as appropriate, are expected to be paid for each of the years ending August 31:

	<u>Pension benefits</u>
2016	\$ 148,300
2017	202,800
2018	259,700
2019	323,300
2020	357,300
2021 - 2025	1,985,700

The following table presents information about the Plan's long-term investments that are measured at fair value as of August 31, 2015 and August 31, 2014 and indicates the fair value hierarchy of the valuation techniques utilized to determine such fair value:

	2015			Total
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
Cash	\$ 637	\$ -	\$ -	\$ 637
Mutual funds:				
International equity funds	780,095	-	-	780,095
Domestic equity fund	883,576	-	-	883,576
Fixed income fund	845,230	-	-	845,230
Balanced funds	3,431,325	-	-	3,431,325
Total	<u>\$ 5,940,863</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 5,940,863</u>

## The Welch Foundation

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED As of and for the years ended August 31, 2015 and 2014

#### NOTE G – EMPLOYEE BENEFIT PLANS – Continued

	2014			
	Level 1	Level 2	Level 3	Total
Mutual funds:				
International equity funds	\$ 838,143	\$ -	\$ -	\$ 838,143
Domestic equity fund	885,016	-	-	885,016
Fixed income fund	887,071	-	-	887,071
Balanced funds	3,502,692	-	-	3,502,692
Total	\$ 6,112,922	\$ -	\$ -	\$ 6,112,922

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 made contributions of \$42,195 and \$40,936 to the Thrift Plan in 2015 and 2014, respectively.

#### NOTE H – COMMITMENTS AND CONTINGENCIES

In 2014, the Foundation amended the existing operating lease which expires on February 28, 2016. The amendment extends the lease for ten years through February 28, 2026. The amended lease can be extended for either two consecutive periods of five years or one consecutive period of ten years. Under the lease, annual minimum rentals are approximately \$255,000 through February 26, 2016 subject to annual operating cost increases. During the first year of the extended lease, the annual minimum rental is approximately \$330,000 and will increase 2.5% per year for the remainder of the lease. Rental expense for the years ended August 31, 2015 and 2014 were approximately \$303,000 and \$292,000, respectively. Additionally, there was an offset to the base rental of \$233,180 for office improvements with any unused amount applied to the base rental commencing on the first day of the extension term. The amount of \$97,174 was applied to the base rent starting March 1, 2016 which represents the unused amount.

#### NOTE I – SUBSEQUENT EVENTS

The Foundation evaluated all events or transactions that occurred after August 31, 2015, up through May 25, 2016, the date the financial statements are available to be issued and noted the following events.

The Foundation froze participation and ceased benefit accruals in the Defined Benefit Retirement Plan effective December 31, 2015. The Foundation terminated the Defined Benefit Plan effective March 31, 2016.

Effective January 1, 2016 the Foundation began contributing 12% of defined compensation to the Thrift Plan of the Robert A. Welch Foundation on behalf of employees who are eligible to participate in the Plan.