

Consolidated Financial Statements and Report of
Independent Certified Public Accountants

The Welch Foundation

August 31, 2016 and 2015

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 |



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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, 2016 and 2015, 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 29% and 27% of total consolidated assets as of August 31, 2016 and 2015, respectively, total net assets of 30% and 28% of total consolidated net assets as of August 31, 2016 and 2015, respectively, and total revenues of 7% and 5% 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, 2016 and 2015, 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

June 7, 2017

The Welch Foundation

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
As of August 31, 2016 and 2015

| | 2016 | 2015 |
|--|----------------|----------------|
| ASSETS | | |
| CASH AND CASH EQUIVALENTS | \$ 3,148,546 | \$ 1,788,185 |
| INVESTMENTS | 632,101,147 | 637,794,514 |
| RECEIVABLES: | | |
| Investment transactions | 462,295 | 1,982,134 |
| Interest and dividends | 399,964 | 435,189 |
| Other | 380,176 | 280,436 |
| Total receivables | 1,242,435 | 2,697,759 |
| OTHER ASSETS | 765,459 | 909,582 |
| TOTAL | \$ 637,257,587 | \$ 643,190,040 |
| LIABILITIES AND NET ASSETS | | |
| LIABILITIES: | | |
| Unpaid grants | \$ 20,477,500 | \$ 20,726,250 |
| Deferred federal excise tax payable | 1,077,887 | 1,138,261 |
| Accounts payable and other | 970,608 | 553,426 |
| Investment transactions payable | 133,002 | 1,779,324 |
| Total liabilities | 22,658,997 | 24,197,261 |
| COMMITMENTS AND CONTINGENCIES | | |
| NET ASSETS (DEFICIT): | | |
| Permanently restricted - principal fund | 635,684,045 | 639,735,026 |
| Unrestricted deficit - income fund | (21,585,455) | (21,242,247) |
| Temporarily restricted - Section 10 fund | 500,000 | 500,000 |
| Total net assets | 614,598,590 | 618,992,779 |
| TOTAL | \$ 637,257,587 | \$ 643,190,040 |

The accompanying notes are an integral part of these statements.

The Welch Foundation

CONSOLIDATED STATEMENT OF ACTIVITIES
For the year ended August 31, 2016

| | 2016 | | | Total |
|--|---|--|--|-----------------------|
| | Permanently Restricted - Principal Fund | Unrestricted Deficit - Income Fund | Temporarily Restricted - Section 10 Fund | |
| REVENUES: | | | | |
| Interest | \$ - | \$ 1,343,847 | \$ 7,030 | \$ 1,350,877 |
| Dividends | - | 3,696,628 | - | 3,696,628 |
| Oil and gas royalties and other | - | 1,128,888 | - | 1,128,888 |
| Total revenues | - | 6,169,363 | 7,030 | 6,176,393 |
| EXPENSES: | | | | |
| Investment advisory and custodial fees | - | 3,481,161 | - | 3,481,161 |
| General and administrative | - | 3,300,682 | - | 3,300,682 |
| Federal excise tax provision on net investment income | - | 82,672 | - | 82,672 |
| Property and production taxes | - | 105,471 | - | 105,471 |
| Advisory board fees and expenses | - | 555,833 | - | 555,833 |
| Total expenses | - | 7,525,819 | - | 7,525,819 |
| GRANTS APPROVED - Net | - | (30,385,590) | - | (30,385,590) |
| NET REALIZED GAINS ON SALES OF INVESTMENTS AND OTHER ASSETS | | | | |
| | 38,398,354 | - | 4,412 | 38,402,766 |
| UNREALIZED (DEPRECIATION) APPRECIATION OF INVESTMENTS | | | | |
| | (10,321,871) | - | 11,422 | (10,310,449) |
| CHANGE IN PENSION | - | (503,771) | - | (503,771) |
| FEDERAL EXCISE TAX ON REALIZED CAPITAL GAINS | (308,093) | - | - | (308,093) |
| DEFERRED FEDERAL EXCISE TAX BENEFIT ON UNREALIZED CAPITAL GAINS | 60,374 | - | - | 60,374 |
| PRINCIPAL TO INCOME TRANSFER | (30,379,102) | 30,379,102 | - | - |
| ALLOCATION OF PRINCIPAL TO INCOME | (1,516,477) | 1,516,477 | - | - |
| SECTION 10 TRANSFER | 15,834 | 7,030 | (22,864) | - |
| CHANGE IN NET ASSETS | (4,050,981) | (343,208) | - | (4,394,189) |
| NET ASSETS (DEFICIT), beginning of year | 639,735,026 | (21,242,247) | 500,000 | 618,992,779 |
| NET ASSETS (DEFICIT), end of year | <u>\$ 635,684,045</u> | <u>\$ (21,585,455)</u> | <u>\$ 500,000</u> | <u>\$ 614,598,590</u> |

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 | |
| REVENUES: | | | | |
| 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 |
| EXPENSES: | | | | |
| 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) |
| NET REALIZED GAINS ON SALES OF INVESTMENTS AND OTHER ASSETS | | | | |
| | 40,498,557 | - | 1,580 | 40,500,137 |
| UNREALIZED (DEPRECIATION) APPRECIATION OF INVESTMENTS | | | | |
| | (66,452,469) | - | 1,940 | (66,450,529) |
| CHANGE IN PENSION | - | (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 | <u>\$ 639,735,026</u> | <u>\$ (21,242,247)</u> | <u>\$ 500,000</u> | <u>\$ 618,992,779</u> |

The accompanying notes are an integral part of these statements.

The Welch Foundation

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended August 31, 2016 and 2015

| | 2016 | 2015 |
|---|----------------|-----------------|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Change in net assets | \$ (4,394,189) | \$ (54,433,585) |
| Adjustments to reconcile change in net assets to net cash used in operating activities: | | |
| Depreciation and amortization | 139,439 | 221,246 |
| Net realized gain on sales of investments | (38,398,354) | (40,498,557) |
| Unrealized depreciation of investments | 10,321,871 | 66,452,469 |
| Changes in operating assets and liabilities: | | |
| Decrease (increase) in receivables | 1,455,324 | (6,965) |
| Decrease in other assets | 144,123 | 668,088 |
| Decrease in unpaid grants | (248,750) | (1,836,000) |
| Decrease in deferred federal excise taxes payable | (60,374) | (1,445,688) |
| Increase in accounts payable and other | 417,182 | 2,312 |
| (Decrease) increase in investment transactions payable | (1,646,322) | 986,859 |
| Net cash used in operating activities | (32,270,050) | (29,889,821) |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchases of investments | (159,866,327) | (113,434,148) |
| Proceeds from sales of investments | 181,084,833 | 135,794,327 |
| Return of capital | 12,411,905 | 8,075,415 |
| Net cash provided by investing activities | 33,630,411 | 30,435,594 |
| NET INCREASE IN CASH AND CASH EQUIVALENTS | 1,360,361 | 545,773 |
| CASH AND CASH EQUIVALENTS, beginning of year | 1,788,185 | 1,242,412 |
| CASH AND CASH EQUIVALENTS, end of year | \$ 3,148,546 | \$ 1,788,185 |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION: | | |
| Cash paid during the year for federal excise taxes | \$ 400,000 | \$ 415,000 |

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, 2016 and 2015

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, 2016 and 2015 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, 2016 and 2015

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 2016 and 2015, \$30,379,102 and \$29,317,327, 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, prepaid expenses, 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 \$701,589 and \$333,458 and terminations of \$882,429 and \$1,011,336 for the years ended August 31, 2016 and 2015, respectively (see Note D).

The Welch Foundation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

As of and for the years ended August 31, 2016 and 2015

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, 2016 and 2015, 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 \$118,688,217 as of August 31, 2016 and \$97,943,914 as of August 31, 2015.

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 at August 31, 2016 and 2015, and an equity investment in a limited partnership with a historical cost of \$176,667 at August 31, 2016 and 2015. The Foundation recorded a decrease of (\$2,176,105) and recorded an increase of \$77,942 to these mineral and fee property and the limited partnership investments in 2016 and 2015, 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, 2016 and 2015

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, 2016 and 2015, were as follows:

| | 2016 | | Cumulative unrealized gains (losses) |
|---|-----------------------|-----------------------|--|
| | Fair value | Cost | |
| Domestic equity | \$ 147,744,587 | \$ 122,858,878 | \$ 24,885,709 |
| International equity | 130,364,072 | 98,888,638 | 31,475,434 |
| Emerging market | 46,643,794 | 46,782,462 | (138,668) |
| Hedge fund | 66,518,390 | 60,258,114 | 6,260,276 |
| Private equity | 134,002,921 | 111,258,128 | 22,744,793 |
| Inflation hedging | 27,732,069 | 39,677,961 | (11,945,892) |
| Fixed income: | | | |
| Domestic | 53,871,351 | 52,410,221 | 1,461,130 |
| International | 21,299,530 | 13,694,934 | 7,604,596 |
| Other investments (primarily mineral and fee properties) | 3,924,433 | 3,288,449 | 635,984 |
| Total | <u>\$ 632,101,147</u> | <u>\$ 549,117,785</u> | <u>\$ 82,983,362</u> |

The Welch Foundation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
As of and for the years ended August 31, 2016 and 2015

NOTE B – INVESTMENTS – Continued

| | 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 |
| Total | <u>\$ 637,794,514</u> | <u>\$ 544,489,281</u> | <u>\$ 93,305,233</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, 2016 and 2015

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, 2016 and August 31, 2015 and indicates the fair value hierarchy of the valuation techniques utilized to determine such fair value:

| | 2016 | | | |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
| | Level 1 | Level 2 | Level 3 | Total |
| Domestic equity | \$ 114,298,689 | \$ 33,445,898 | \$ - | \$ 147,744,587 |
| International equity | 37,928,236 | 92,435,836 | - | 130,364,072 |
| Emerging market | - | 46,643,794 | - | 46,643,794 |
| Hedge fund | - | 16,500,573 | 50,017,817 | 66,518,390 |
| Private equity | - | - | 134,002,921 | 134,002,921 |
| Inflation hedging | - | 27,732,069 | - | 27,732,069 |
| Fixed income: | | | | |
| Domestic | 53,871,351 | - | - | 53,871,351 |
| International | - | 21,299,530 | - | 21,299,530 |
| Other investments (primarily mineral and fee properties) | - | - | 3,924,433 | 3,924,433 |
| Total | \$ 206,098,276 | \$ 238,057,700 | \$ 187,945,171 | \$ 632,101,147 |

| | 2015 | | | |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
| | Level 1 | Level 2 | Level 3 | Total |
| 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 |
| Total | \$ 225,775,907 | \$ 231,413,793 | \$ 180,604,814 | \$ 637,794,514 |

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, 2016 and 2015 no investments were transferred between levels.

The Welch Foundation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED As of and for the years ended August 31, 2016 and 2015

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, 2016 and August 31, 2015:

| | 2016 | | | | |
|---|-----------------------|---|---|-----------------------|-----------------------|
| | Beginning balance | Additions, contributions, subscriptions | Distributions, redemptions, transfers out | Unrealized gains | Ending balance |
| Hedge fund | \$ 66,383,796 | \$ 10,000,000 | \$ (24,441,155) | \$ (1,924,824) | \$ 50,017,817 |
| Private equity | 108,120,480 | 40,573,611 | (12,412,736) | (2,278,434) | 134,002,921 |
| Other investments (primarily mineral and fee properties) | 6,100,538 | - | - | (2,176,105) | 3,924,433 |
| Total | \$ 180,604,814 | \$ 50,573,611 | \$ (36,853,891) | \$ (6,379,363) | \$ 187,945,171 |

| | 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 |
| Total | \$ 159,145,317 | \$ 37,982,835 | \$ (16,348,741) | \$ (174,597) | \$ 180,604,814 |

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:

| | 2016 Fair value | Redemption frequency | Redemption notice period | Unfunded commitment |
|--------------------------------|-----------------------|-------------------------|-----------------------------|------------------------|
| Domestic equity (a) | \$ 33,445,898 | Daily | 1 day notice | none |
| International equity (b) | 100,398,522 | Daily to monthly | 1 to 10 days notice | none |
| Emerging markets (c) | 24,103,960 | Monthly | 6 days notice | none |
| Hedge fund (d) | 50,017,817 | Monthly to annually | 45 to 90 days notice | none |
| Inflation hedging (e) | 27,732,069 | Monthly | 10 days notice | none |
| Private equity (f) | 2,745,732 | None | no redemption ability | none |
| Fixed income: | | | | |
| International fixed income (g) | 21,299,530 | Daily | 10 days notice | none |
| Total | \$ 259,743,528 | | | |

The Welch Foundation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED As of and for the years ended August 31, 2016 and 2015

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, 2016, represent commitments for grant disbursements approved but not paid of \$2,841,250 in 2017; \$13,141,500 in 2018; \$4,179,750 in 2019, \$175,000 in 2020; \$105,000 in 2021, and \$35,000 in 2022.

The components of unpaid grants as of August 31, 2016 and 2015 were as follows:

| | 2016 | 2015 |
|---------------------------------------|---------------|---------------|
| Unpaid grants - beginning of the year | \$ 20,726,250 | \$ 22,562,250 |
| Grants approved - net | 30,385,590 | 28,722,825 |
| Grants disbursed | (30,634,340) | (30,558,825) |
| Unpaid grants - end of year | \$ 20,477,500 | \$ 20,726,250 |

The unpaid grants primarily account for the net deficit in the Income Fund of \$21,585,455 and \$21,242,247 as of August 31, 2016 and 2015, respectively, as the grants are approved but not yet paid as of yearend. 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, 2016, 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, 2016 and 2015

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, 2016 and 2015 were as follows:

| | 2016 | 2015 |
|--|------------|--------------|
| Federal excise tax provision on net investment income other than realized capital gains | \$ 82,672 | \$ 94,375 |
| Federal excise tax on realized capital gains | 308,093 | 374,390 |
| Current federal excise tax provision | 390,765 | 468,765 |
| Deferred federal excise tax (benefit) provision on unrealized capital gains | (60,374) | (1,445,688) |
| Total federal excise tax | \$ 330,391 | \$ (976,923) |

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, 2016 and 2015 were as follows:

| | 2016 | 2015 |
|-----------------------------|--------------|--------------|
| Deferred tax excise payable | \$ 1,077,887 | \$ 1,138,261 |

NOTE F – RELATED PARTY TRANSACTIONS

There were no related-party transactions during the year ended August 31, 2016 or 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.

As of December 31, 2015 and March 31, 2016, the Foundation curtailed (“froze”) and then terminated the Plan. 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 has been filed with the Internal Revenue Service.

The Welch Foundation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

As of and for the years ended August 31, 2016 and 2015

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, 2016 and 2015 are as follows:

| | 2016 | 2015 |
|--|--------------|--------------|
| Change in benefit obligation: | | |
| Projected benefit obligation - beginning of year | \$ 5,792,521 | \$ 5,359,713 |
| Service cost | 51,148 | 147,330 |
| Interest cost | 232,803 | 198,403 |
| Actuarial loss | 757,906 | 110,910 |
| Benefits paid | (16,826) | (23,835) |
| Curtailment | (390,372) | - |
| Projected benefit obligation - end of year | \$ 6,427,180 | \$ 5,792,521 |
| Change in plan assets: | | |
| Fair value of plan assets - beginning of year | \$ 5,940,863 | \$ 6,112,922 |
| Actual return on plan assets | 147,714 | (148,224) |
| Benefits paid | (16,826) | (23,835) |
| Fair value of plan assets - end of year | \$ 6,071,751 | \$ 5,940,863 |
| Funded status - reported in other assets | \$ (355,429) | \$ 148,342 |

The Foundation's pension funding decreased by \$503,771 in 2016 and \$604,867 in 2015.

| | 2016 | 2015 |
|--------------------------------|-------------|-------------|
| Net periodic pension cost: | | |
| Service cost | \$ 51,148 | \$ 147,330 |
| Interest cost | 232,803 | 198,403 |
| Expected return on plan assets | (225,901) | (411,818) |
| Amortization of net loss | 307,572 | 22,828 |
| Curtailment | (390,373) | - |
| Net periodic pension cost | \$ (24,751) | \$ (43,257) |

The Welch Foundation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

As of and for the years ended August 31, 2016 and 2015

NOTE G – EMPLOYEE BENEFIT PLANS – Continued

The accumulated benefit obligation for the defined benefit plan for the years ending August 31, 2016 and 2015 was \$6,427,180 and \$5,411,197, respectively.

1. Asset Allocation

Due to the termination of the Plan, all of the Plan's assets are in a money market mutual fund.

| | <u>Current allocation</u> |
|-----------------------|-------------------------------|
| Cash | 93% |
| Domestic fixed income | <u>7%</u> |
| | <u>100%</u> |

The total value of the assets was \$6,071,751 and estimated return from investment income and unrealized gains was approximately 2.5% in fiscal year 2016. In fiscal year 2015, the total value of the assets was \$5,940,863 and estimated return from investment income and unrealized gains was approximately (2.4)%.

2. 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. No contributions were made in the years ended August 31, 2016 and 2015.

3. 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 3.75% (2015: 6.75%). The discount rate used for the calculation of the net periodic benefit cost at the beginning of the year was 4.15% (2015: 3.71%), and the discount rate used for year-end measurements was 3.13% (2015: 4.15%), for the Plan. In determining the pension balance, management considered salary growth rates of 3% (2015: 3%).

The Plan made benefit payments of \$16,826 and \$21,287 for Plan years ended December 31, 2016 and December 31, 2015, respectively.

The Welch Foundation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
As of and for the years ended August 31, 2016 and 2015

NOTE G – EMPLOYEE BENEFIT PLANS – Continued

4. 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:

| | Pension benefits |
|------|---------------------|
| 2017 | \$ 16,826 |
| 2018 | 5,905,582 |

The following table presents information about the Plan’s long-term investments that are measured at fair value as of August 31, 2016 and August 31, 2015 and indicates the fair value hierarchy of the valuation techniques utilized to determine such fair value:

| | 2016 | | | |
|----------------------------|--------------|---------|---------|--------------|
| | Level 1 | Level 2 | Level 3 | Total |
| Mutual fund: | | | | |
| Money market fund | \$ 6,071,751 | - | - | \$ 6,071,751 |
| Total | \$ 6,071,751 | \$ - | \$ - | \$ 6,071,751 |
| | | | | |
| | 2015 | | | |
| | Level 1 | Level 2 | Level 3 | Total |
| 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 | \$ 5,940,863 | \$ - | \$ - | \$ 5,940,863 |

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 \$127,643 and \$42,195 to the Thrift Plan in 2016 and 2015, respectively.

The Welch Foundation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
As of and for the years ended August 31, 2016 and 2015

NOTE H – COMMITMENTS AND CONTINGENCIES

In 2014, the Foundation amended the existing operating lease which would have expired on February 28, 2016. The amendment extended the lease for ten years through February 28, 2026. The amended lease can be further 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 28 2016 subject to annual operating cost increases. During the first year of the extended lease, the annual minimum rental was approximately \$330,000 and will increase 2.5% per year for the remainder of the lease. Rental expense for the years ended August 31, 2016 and 2015 were approximately \$326,000 and \$303,000, 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, 2016, up through June 7, 2017, the date the financial statements are available to be issued. During this period, the Foundation did not have any material recognizable subsequent events.