

Consolidated Financial Statements and
Report of Independent Certified Public
Accountants

The Welch Foundation

August 31, 2020 and 2019

Contents

Page

Report of Independent Certified Public Accountants	3
Financial Statements	
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 LLP

1717 Main ST, Suite 1800
Dallas, TX 75201-4657

D 214 561 2300

F 214 561 2370

S [linkd.in/granthorntonus](https://www.linkedin.com/company/granthorntonus)

twitter.com/granthorntonus

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, the RWF Fund, LP, which comprise the consolidated statements of financial position as of August 31, 2020 and 2019, 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 47% and 46% of total consolidated assets as of August 31, 2020 and 2019, respectively, total net assets of 55% and 47% of total consolidated net assets as of August 31, 2020 and 2019, respectively, and total revenues of 13% and 10% 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, 2020 and 2019, and the changes in their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.



Dallas, Texas
May 6, 2021

The Welch Foundation
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
As of August 31, 2020 and 2019

	<u>2020</u>	<u>2019</u>
ASSETS		
CASH AND CASH EQUIVALENTS	\$ 16,596,249	\$ 2,467,935
INVESTMENTS	730,818,871	703,185,799
RECEIVABLES		
Investment transactions	772,809	385,062
Interest and dividends	46,734	204,281
Other	<u>594,560</u>	<u>788,975</u>
Total receivables	<u>1,414,103</u>	<u>1,378,318</u>
OTHER ASSETS	<u>1,578,935</u>	<u>1,022,718</u>
Total	<u>\$ 750,408,158</u>	<u>\$ 708,054,770</u>
LIABILITIES AND NET ASSETS		
LIABILITIES		
Unpaid grants	\$ 111,269,748	\$ 23,375,886
Current and deferred federal excise tax payable	1,813,784	1,499,273
Accounts payable and other	<u>227,569</u>	<u>182,339</u>
Total liabilities	<u>113,311,101</u>	<u>25,057,498</u>
NET ASSETS (DEFICIT)		
With donor restrictions	748,317,284	706,600,345
Without donor restrictions	<u>(111,220,227)</u>	<u>(23,603,073)</u>
Total net assets	<u>637,097,057</u>	<u>682,997,272</u>
Total	<u>\$ 750,408,158</u>	<u>\$ 708,054,770</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, 2020

	2020		
	With Donor Restrictions	Without Donor Restrictions	Total
Revenues, income, and gains (losses)			
Interest and dividends	\$ 9,086	\$ 3,161,645	\$ 3,170,731
Oil and gas royalties and other	-	2,233,323	2,233,323
Net realized gains on sales of investments	34,026,148	-	34,026,148
Unrealized appreciation of investments	43,334,312	-	43,334,312
Unrealized appreciation of other assets	17,958	-	17,958
Investment management expenses	-	(3,421,203)	(3,421,203)
Federal excise tax provision	-	(334,443)	(334,443)
Total net investment income and gains	<u>77,387,504</u>	<u>1,639,322</u>	<u>79,026,826</u>
Expenses			
Grants approved, net	-	119,729,246	119,729,246
Grants administration	-	3,342,084	3,342,084
General and administrative	-	1,541,200	1,541,200
Total expenses	<u>-</u>	<u>124,612,530</u>	<u>124,612,530</u>
Deferred federal excise tax provision on unrealized capital gains	(314,511)	-	(314,511)
Restricted to unrestricted transfer	(34,398,433)	34,398,433	-
Allocation of restricted to unrestricted	(948,535)	948,535	-
Section 10 transfer	<u>(9,086)</u>	<u>9,086</u>	<u>-</u>
Change in net assets	41,716,939	(87,617,154)	(45,900,215)
Net assets (deficit), beginning of year	<u>706,600,345</u>	<u>(23,603,073)</u>	<u>682,997,272</u>
Net assets (deficit), end of year	<u>\$ 748,317,284</u>	<u>\$ (111,220,227)</u>	<u>\$ 637,097,057</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		
	With Donor Restrictions	Without Donor Restrictions	Total
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	16,268,598	2,380,825	18,649,423
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	-	38,190,015	38,190,015
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	(10,675)	10,675	-
Change in net assets	(16,297,082)	(2,021,599)	(18,318,681)
Net assets (deficit), beginning of year	722,897,427	(21,581,474)	701,315,953
Net assets (deficit), end of year	\$ 706,600,345	\$ (23,603,073)	\$ 682,997,272

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, 2020 and 2019

	<u>2020</u>	<u>2019</u>
Cash flows from operating activities:		
Change in net assets	\$ (45,900,215)	\$ (18,318,681)
Adjustments to reconcile change in net assets to net cash used in operating activities		
Amortization	(1,781)	(14,877)
Net realized gain on sales of investments	(34,026,148)	(63,335,646)
Change in recorded cost of securities		
Unrealized (appreciation) depreciation of securities	(43,334,312)	47,113,066
Changes in operating assets and liabilities		
Increase in receivables	(35,785)	(474,739)
Increase in other assets	(556,217)	(437,319)
Increase in unpaid grants	87,893,862	2,157,133
Increase (decrease) in current and deferred federal excise taxes payable	314,511	(1,231,073)
Increase (decrease) in accounts payable and other	45,230	(189,852)
Net cash used in operating activities	<u>(35,600,855)</u>	<u>(34,731,988)</u>
Cash flows from investing activities:		
Purchases of investments	(129,043,381)	(213,684,150)
Proceeds from sales of investments	159,265,277	230,218,597
Return of capital	19,507,273	18,602,835
Net cash provided by investing activities	<u>49,729,169</u>	<u>35,137,282</u>
Net increase in cash and cash equivalents	14,128,314	405,294
Cash and equivalents, beginning of year	<u>2,467,935</u>	<u>2,062,641</u>
Cash and cash equivalents, end of year	<u>\$ 16,596,249</u>	<u>\$ 2,467,935</u>
Supplemental disclosures of cash flow information:		
Cash paid during the year for federal excise taxes	<u>\$ 870,000</u>	<u>\$ 1,170,000</u>

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

The Welch Foundation
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
August 31, 2020 and 2019

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, 2020 and 2019 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 U.S. generally accepted accounting principles ("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, 2020 and 2019

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 2020 and 2019, \$34,398,433 and \$32,854,108, 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 \$671,933 and \$997,751 and terminations of \$543,500 and \$589,750 for the years ended August 31, 2020 and 2019, respectively (see Note D).

Current Accounting Pronouncements

In June 2018, the Financial Accounting Standards Board (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 accounting pronouncement clarified guidance for not-for-profit entities regarding whether transactions should be accounted for as contributions (nonreciprocal transactions) or as exchange (reciprocal) transactions. It also clarified guidance related to determining whether a contribution is conditional. The Foundation adopted the provisions of this new standard during the year ended August 31, 2020. There were no material changes to the recognition or presentation of contributions made as a result of the application of ASU 2018-08.

The Welch Foundation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2020 and 2019

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

In August 2018, the FASB issued ASU 2018-13, *Changes to the Disclosure Requirements for Fair Value Measurement (Topic 820)*. The new standard modifies certain Level 3 disclosures, which notes in lieu of a rollforward of Level 3 fair value measurements, the Foundation would add a disclosure of transfers into and out of Level 3 fair value hierarchy and purchases and issues of Level 3 assets and liabilities. The Foundation has elected to continue to include the rollforward of Level 3 fair value measurements as management has determined that it is useful to the readers of the financial statements.

Future Accounting Pronouncements

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, and early adoption is permitted. 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 \$148,146,097 as of August 31, 2020 and \$160,419,360 as of August 31, 2019.

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, 2020 and 2019, and an equity investment in a limited partnership with a historical cost of \$176,667 at August 31, 2020 and 2019. The Foundation recorded an increase of \$3,694,962 and \$425,126 to these mineral and fee properties and the limited partnership investments in 2020 and 2019, respectively. Mineral property investments are valued based on a multiple of income approach for August 31, 2020. For August 31, 2019 valuations for mineral property investments are based on a multiple of income approach in Louisiana and tax appraisals for Texas properties. Fee properties are recorded based on tax appraisals for August 31, 2020 and August 31, 2019.

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.

The Welch Foundation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2020 and 2019

NOTE B - INVESTMENTS - CONTINUED

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 on investments as of August 31, 2020 and 2019, were as follows:

	2020		Cumulative Unrealized Gains
	Fair Value	Cost	
Domestic equity	\$ 142,379,150	\$ 115,663,286	\$ 26,715,864
International equity	120,563,507	75,744,369	44,819,138
Emerging market	47,359,534	45,249,156	2,110,378
Hedge fund	92,476,151	78,778,708	13,697,443
Private equity	255,820,467	204,736,258	51,084,209
Fixed income:			
Domestic	52,211,196	48,990,582	3,220,614
International	12,763,505	7,143,919	5,619,586
Other investments (primarily mineral and fee properties)	7,245,361	3,288,449	3,956,912
Total	<u>\$ 730,818,871</u>	<u>\$ 579,594,727</u>	<u>\$ 151,224,144</u>
	2019		Cumulative Unrealized Gains
	Fair Value	Cost	
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	<u>\$ 703,185,799</u>	<u>\$ 595,295,967</u>	<u>\$ 107,889,832</u>

The Welch Foundation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2020 and 2019

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.

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, 2020 and 2019 and indicates the fair value hierarchy of the valuation techniques utilized to determine such fair value:

	2020			
	Level 1	Level 2	Level 3	Total
Domestic equity	\$ 68,795,723	\$ -	\$ -	\$ 68,795,723
International equity	-	25,092,343	-	25,092,343
Emerging market	-	33,465,105	-	33,465,105
Private equity	-	-	255,760,924	255,760,924
Fixed income	40,207,243	-	-	40,207,243
Other investments (primarily mineral and fee properties)	-	-	7,245,361	7,245,361
Total	<u>\$ 109,002,966</u>	<u>\$ 58,557,448</u>	<u>\$ 263,006,285</u>	430,566,699
NAV investments				<u>300,252,172</u>
Total fair value				<u>\$ 730,818,871</u>

The Welch Foundation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2020 and 2019

NOTE C - FAIR VALUE OF INVESTMENTS - CONTINUED

	2019			
	Level 1	Level 2	Level 3	Total
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>

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, 2020 and 2019, 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, 2020 and August 31, 2019:

	2020				
	Beginning Balance	Additions, Contributions, Subscriptions	Distributions, Redemptions, Transfers Out	Unrealized Gains	Ending Balance
Private equity	\$ 212,285,065	\$ 51,620,452	\$ (19,516,574)	\$ 11,371,981	\$ 255,760,924
Other investments (primarily mineral and fee properties)	3,550,399	-	-	3,694,962	7,245,361
Total	<u>\$ 215,835,464</u>	<u>\$ 51,620,452</u>	<u>\$ (19,516,574)</u>	<u>\$ 15,066,943</u>	<u>\$ 263,006,285</u>

	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>

The Welch Foundation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2020 and 2019

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 Net Asset Value:

	<u>2020 Fair Value</u>	<u>Redemption Frequency</u>	<u>Redemption Notice Period</u>	<u>Unfunded Commitment</u>
Domestic equity (a)	\$ 73,583,427	Daily	1 day notice	None
International equity (b)	95,471,164	Monthly to annually	10 to 45 days notice	None
Emerging markets (c)	13,894,429	Monthly	6 days notice	None
Hedge fund (d)	92,476,151	Monthly to annually	5 to 90 days notice	None
Private equity (e)	59,543	None	No redemption ability	None
International fixed income (f)	12,763,505	Daily	10 days notice	None
Treasury inflation-protection security (g)	<u>12,003,953</u>	Daily	1 day notice	None
Total	<u>\$ 300,252,172</u>			

	<u>2019 Fair Value</u>	<u>Redemption Frequency</u>	<u>Redemption Notice Period</u>	<u>Unfunded Commitment</u>
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)	<u>13,489,182</u>	Daily	1 day notice	None
Total	<u>\$ 308,888,208</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.

The Welch Foundation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2020 and 2019

NOTE D - UNPAID GRANTS

The Foundation's unpaid grants at August 31, 2020 represent commitments for grant disbursements approved but not paid of \$13,541,500 in 2021; \$18,821,000 in 2022; \$12,561,000 in 2023, \$10,101,500 in 2024, \$10,035,000 in 2025, \$10,000,000 in 2026, 2027, 2028, and 2029 and \$9,750,000 in 2030.

The components of unpaid grants as of August 31, 2020 and 2019 were as follows:

	<u>2020</u>	<u>2019</u>
Unpaid grants - beginning of the year	\$ 23,375,886	\$ 21,218,753
Grants approved - net	123,269,498	34,518,763
Grants disbursed	<u>(31,835,384)</u>	<u>(31,875,016)</u>
Unpaid grants - end of year before discount	114,810,000	23,862,500
Less discount to reflect grants payable at present value	<u>(3,540,252)</u>	<u>(486,614)</u>
Unpaid grants - end of year	<u>\$ 111,269,748</u>	<u>\$ 23,375,886</u>

The unpaid grants primarily account for the net deficit in the Income Fund of \$111,220,227 and \$23,603,073 as of August 31, 2020 and 2019, respectively, as the grants are approved but not yet paid as of year end. The Foundation approved a grant to fund Rice University and The Welch Institute over a ten year period. The total amount of the grant is \$100,000,000. As of August 31, 2020 the Foundation had funded \$250,000 of this grant.

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 AND DEFERRED INCOME TAX

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, 2020 and 2019 the Foundation qualified under IRC Section 4940(e) for a reduced rate of 1%. For tax years beginning after December 20, 2019, there is a fixed rate of 1.39% on net investment income. This has been applied to the deferred federal excise tax reporting.

The Welch Foundation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2020 and 2019

NOTE E - FEDERAL EXCISE TAX AND DEFERRED INCOME 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, 2020 and 2019 were as follows:

	2020	2019
Federal excise tax provision on net investment income other than realized capital gains	\$ 72,185	\$ 57,669
Federal excise tax on realized capital gains	262,258	701,555
Current federal excise tax provision	334,443	759,224
Deferred federal excise tax provision (benefit) on unrealized capital gains	314,511	(1,221,911)
Total federal excise tax expense (benefit)	<u>\$ 648,954</u>	<u>\$ (462,687)</u>

The Foundation records 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, 2020 and 2019 were as follows:

	2020	2019
Deferred federal tax excise payable	<u>\$ 1,813,784</u>	<u>\$ 1,499,273</u>

Deferred Income Tax

As of August 31, 2020 and 2019, The Foundation has federal income tax net operating loss (NOL) carryforwards that result in the following deferred income tax asset:

	2020	2019
Deferred income tax asset	\$ 2,662,266	\$ 2,111,727
Income tax valuation allowance	<u>(2,662,266)</u>	<u>(2,111,727)</u>
Deferred income tax asset – end of year	<u>\$ -</u>	<u>\$ -</u>

The Foundation believes that it is more likely than not that the benefit from federal NOL carryforward will not be realized. In recognition of this risk, the Foundation has provided a valuation allowance of \$2,662,266 and \$2,111,727 on the deferred tax assets related to the federal NOL carryforward for the year ended August 31, 2020 and 2019, respectively. If its assumptions change and the Foundation determines that it will be able to realize the NOL, the tax benefits related to any reversal of the valuation allowance on deferred tax assets as of August 31, 2020 and 2019, will be accounted for accordingly.

The Welch Foundation
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
August 31, 2020 and 2019

NOTE F - RELATED PARTY TRANSACTIONS

There were no related-party transactions during the year ended August 31, 2020 or 2019.

NOTE G - EMPLOYEE BENEFIT PLANS

Employees are 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 \$195,136 and \$162,111 to the Thrift Plan in 2020 and 2019, 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 \$355,000 as of August 31, 2020 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, 2020 and 2019 were approximately \$495,000 and \$540,000, 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 following is a functional classification of the Foundation's expenses:

	2020			
	Grants Approved, Net	Grant Administration	General and Administrative	Total
Grants approved, net	\$ 119,729,246	\$ -	\$ -	\$ 119,729,246
Payroll and employee costs	-	1,475,891	980,145	2,456,036
Board and professional fees	-	1,260,030	194,910	1,454,940
Occupancy	-	292,561	198,395	490,956
Other operating costs	-	313,602	167,750	481,352
Total functional expenses	\$ 119,729,246	\$ 3,342,084	\$ 1,541,200	\$ 124,612,530

The Welch Foundation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

August 31, 2020 and 2019

NOTE I - FUNCTIONAL EXPENSES - CONTINUED

	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
Total functional expenses	<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:

	2020	2019
Cash and cash equivalents	\$ 16,596,249	\$ 2,467,935
Liquid investments (excludes private equity and other investments)	467,753,041	487,283,195
Receivables and other investments	<u>1,414,103</u>	<u>1,378,318</u>
Financial assets available for general expenditures within one year	485,763,393	491,129,448
Amounts unavailable to management without Board's approval	<u>(467,753,041)</u>	<u>(487,283,195)</u>
Total financial assets available to management within one year	<u>\$ 18,010,352</u>	<u>\$ 3,846,253</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

The Foundation evaluated all events or transactions that occurred after August 31, 2020, up through May 6, 2021, the date the consolidated financial statements were available to be issued. During this period, the Foundation did not have any subsequent events which would require recognition or disclosure in the consolidated financial statements.