

PERMIAN BASIN AREA  
*Foundation*

**Consolidated Financial Statements**

*Year Ending December 31, 2018*

*With Independent Auditor's Report*



**JOHNSON & SHELDON, PLLC**

CERTIFIED PUBLIC ACCOUNTANTS

Permian Basin Area Foundation  
Consolidated Financial Statements  
Year Ending December 31, 2018

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# JOHNSON & SHELDON, PLLC

## CERTIFIED PUBLIC ACCOUNTANTS

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Board of Governors  
Permian Basin Area Foundation  
Midland, Texas

### INDEPENDENT AUDITOR'S REPORT

#### Report on the Financial Statements

We have audited the accompanying consolidated financial statements of **Permian Basin Area Foundation** (the Foundation), which comprise the consolidated statement of financial position as of December 31, 2018, the related consolidated statements of activities and cash flow for the year then ended, and the related notes to the consolidated financial statements (collectively, the financial statements).

#### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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 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 financial statements based on our audit. We conducted our audit 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 financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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 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 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, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Foundation as of December 31, 2018, and the changes in its consolidated net assets and its consolidated cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

*Johnson & Sheldon, PLLC*

**Johnson & Sheldon, PLLC**  
**Amarillo, Texas**  
April 26, 2019

Consolidated Financial Statements



Permian Basin Area Foundation  
Consolidated Statement of Financial Position  
Year Ending December 31, 2018

**Assets:**

Cash and cash equivalents	\$	3,909,522
Investments (Note 3)		150,374,858
Prepaid expenses		34,126
Bequest receivable		1,500,000
Beneficial interest in remainder trust (Note 11)		1,624,256
Beneficial interest in lead trust (Note 12)		1,090,588
Beneficial interest in royalty trust (Note 13)		3,358,697
Beneficial interest in perpetual trust		44,917
Oil and gas royalties- held for sale		16,660,243
Limited partnership interest		176,670
Cash surrender value of life insurance		233,549
Property and equipment, net of accumulated depreciation of \$163,134		4,588,911

<b>Total Assets</b>	<b>\$</b>	<b><u>183,596,337</u></b>
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Liabilities:

Grants and scholarships payable	\$	10,000
Funds held for agencies (Note 7)		18,000,524
Total Liabilities		<u>18,010,524</u>

**Net Assets:**

Without Donor Restrictions (Note 8)		146,282,657
With Donor Restrictions (Note 8)		19,303,156
Total Net Assets		<u>165,585,813</u>

<b>Total Liabilities and Net Assets</b>	<b>\$</b>	<b><u>183,596,337</u></b>
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*See accompanying notes to consolidated financial statements and independent auditor's report.*



Permian Basin Area Foundation  
Consolidated Statement of Activities  
Year Ending December 31, 2018

	<i>Without Donor Restrictions</i>	<i>With Donor Restrictions</i>	<i>Total</i>
<b><i>Revenues, gains, and other support</i></b>			
Contributions	\$ 8,740,039	\$ 7,858,697	\$ 16,598,736
Investment return, net	(9,420,562)	399,745	(9,020,817)
Royalty income	5,775,582	0	5,775,582
Change in value of oil and gas royalties	488,646	0	488,646
Change in value of split interest agreements	0	192,430	192,430
Change in value of perpetual trust	0	(4,708)	(4,708)
Change in value of partnership interest	141,720	0	141,720
Special event revenue	120,162	0	120,162
Gain on sales of assets	2,998,616	0	2,998,616
Grant rescissions and other income	472,845	20,000	492,845
Net assets released from restrictions	219,072	(219,072)	0
Total revenues, gains and other support	<b>\$ 9,536,120</b>	<b>\$ 8,247,092</b>	<b>\$ 17,783,212</b>
<b><i>Expenses</i></b>			
Grants and scholarships awarded	\$ 6,052,660	\$ 0	\$ 6,052,660
Program expenses	401,020	0	401,020
General and administrative	1,386,179	0	1,386,179
Fundraising	229,039	0	229,039
Total expenses and distributions	8,068,898	0	8,068,898
<b><i>Increase in net assets</i></b>	1,467,222	8,247,092	9,714,314
Net assets at beginning of year	144,815,435	11,056,064	155,871,499
Net assets at end of year	<b>\$ 146,282,657</b>	<b>\$ 19,303,156</b>	<b>\$ 165,585,813</b>

See accompanying notes to consolidated financial statements and independent auditor's report.



Permian Basin Area Foundation  
Consolidated Statement of Cash Flows  
Year Ending December 31, 2018

***Cash flows from operating activities***

Increase in net assets	\$ 9,714,314
Adjustments to reconcile increase in net assets to net cash provided by (used for) operating activities:	
Depreciation	102,137
Gain on sale of assets	(2,998,616)
Gifts of public securities	(2,646,668)
Gift of fixed assets	(26,000)
Gift of beneficial interest in royalty trust	(3,358,697)
Realized gains from sales of investments, net	(822,628)
Unrealized loss on investments, net	14,864,562
Change in value of split interest agreements	(60,310)
Change in value of oil and gas royalties	(488,646)
Change in value of partnership interest	(141,720)
Increase in cash surrender value of life insurance	(71,593)
Decrease in grants payable	(35,000)
Decrease in funds held for agencies	(1,334,182)
Decrease in prepaid expenses	9,663
Decrease in accrued interest receivable	41,710
Increase in bequests receivable	(1,500,000)
Net cash provided by operating activities	11,248,326

***Cash flows from investing activities***

Purchases of equipment and property construction	(1,911,656)
Purchases of investments	(54,826,227)
Proceeds from sale of oil and gas royalties	2,626,062
Proceeds from sale of real estate	1,500,423
Proceeds from sales of investments	35,126,531
Net cash used for investing activities	(17,484,867)
Net decrease in cash and cash equivalents	(6,236,541)
Cash and cash equivalents – Beginning of year	10,146,063
Cash and cash equivalents – End of year	\$ 3,909,522

*See accompanying notes to consolidated financial statements and independent auditor's report.*



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# Permian Basin Area Foundation

## Notes to Consolidated Financial Statements

### Year Ending December 31, 2018

#### 1. Description of Organization

Permian Basin Area Foundation (the Foundation) is a Texas non-profit corporation classified by the Internal Revenue Service as tax-exempt under Section 501(c)(3) and as a non-private foundation under Section 509(a)(1) of the Internal Revenue Code (the Code). The Foundation is a community foundation that primarily serves West Texas. In partnership with many donors, the Foundation facilitates the creation of permanent charitable funds and provides grants to address community needs and enrich the quality of life in the Permian Basin.

The accompanying consolidated financial statements include the accounts of West Texas Heritage Holdings, Inc., a Type 1 supporting organization which was established in 2010. As of December 31, 2018, the balances of West Texas Heritage Holdings, Inc. primarily included a bequest receivable, a limited partnership interest and cash. All significant intercompany accounts and transactions have been eliminated.

#### 2. Summary of Significant Accounting Policies

##### *Basis of Presentation*

The Foundation's consolidated financial statements have been prepared on the accrual basis of accounting, which recognizes revenue and support when earned and expenses when incurred. The statements have been prepared in accordance with the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 958, *Not-for-Profit Entities – Overall*. The Foundation reports information regarding its financial position and activities according to two classes of net assets: with donor restrictions and without donor restrictions.

##### *Net Asset Classifications*

The Foundation complies with the FASB ASC Topic 958, *Not-for-Profit Entities – Overall* (FASB ASC 958), which provides guidance on the net asset classification of donor-restricted endowment funds for a not-for-profit organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA). FASB ASC 958 also improves disclosures about an organization's endowment funds (both donor restricted endowment funds and board designated endowment funds) whether or not the organization is subject to UPMIFA.

The State of Texas adopted UPMIFA effective September 1, 2007. The Board of Governors, on the advice of legal counsel, has determined that the majority of the Foundation's net assets do not meet the definition of "endowment" under UPMIFA. The majority of the Foundation's net assets do meet the definition of "endowment" under FASB ASC 958, *Not-for-Profit Entities – Overall*, and are subject to the enhanced disclosures for all endowment funds. The Foundation is governed by the Articles of Incorporation of the Foundation, and contributions are subject to the terms of the Articles of Incorporation.

Certain contributions are received subject to other gift instruments or provisions of specific agreements between donors and the Foundation.



# Permian Basin Area Foundation

## Notes to Consolidated Financial Statements

### Year Ending December 31, 2018

#### 2. Summary of Significant Accounting Policies, continued

Under the terms of the Articles of Incorporation, the Board of Governors may modify any restriction or condition on the distribution of funds of any separate gift, devise, bequest or fund at its sole discretion. As a result of the ability to modify any restriction or condition on the distribution of funds, all contributions not classified as net assets with donor restrictions are classified as net assets without donor restrictions for financial statement purposes.

Net assets with donor restrictions represent those net assets resulting from gifts or grants received by the Foundation that are restricted as to purpose of use or period of time, such as for special projects. When donor restrictions expire, that is, when a stipulated time restriction ends or a purpose restriction is fulfilled, net assets with donor restrictions are reclassified to net assets without donor restrictions and reported in the consolidated statement of activities as net assets released from restrictions.

#### *Endowment Investment and Spending Policies*

The Foundation has adopted investment and spending policies for endowment assets that attempt to protect the corpus of funds by minimizing risks from either market or credit factors and to increase the value of the corpus through the managed pursuit of investment opportunities. The objective rate of return of the investment pool is a rate that exceeds the sum of inflation, as measured by the Consumer Price Index, investment fees, administration fees, and the Foundation's distribution rate, over rolling five-year periods. Investment return is defined as the total return, including all income derived from an investment, realized and unrealized gains and losses, less all applicable expenses.

To achieve its objectives, the Foundation employs a strategy of defined asset allocation to diversify its position in permissible investments, disciplined re-balancing to maintain asset allocation, and diligent selection and performance monitoring of investment managers. The Foundation's investment allocation model is based on efficient portfolio theory using an anticipated return of the total portfolio of 10.00%, with a standard deviation of 11.05%. The Foundation targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk parameters.

The amount available for distributions from endowment funds is determined annually by the Foundation's Board of Governors based on a percentage of the market value of the fund. In setting the distribution policy, the Board considers the total average rate of return for the previous twelve quarters, allowance for administrative and investment fees, and long-term objective of fund growth. The Board of Governors approved a distribution policy for 2018 of 4%.

#### *Cash and Cash Equivalents*

Cash and cash equivalents consist of cash and money market accounts available for current use with an initial maturity of three months or less. Cash and cash equivalents included in brokerage accounts that represent resources that are not segregated for operating use are classified as investments.

#### *Concentration of Credit Risk*

The Foundation maintains bank accounts at various financial institutions. Accounts are insured by the Federal Deposit Insurance Corporation (FDIC). From time to time, the Foundation may have balances in bank accounts which exceed the federally insured limit. The Foundation does not anticipate any loss associated with balances in excess of the federally insured limit.



# Permian Basin Area Foundation

## Notes to Consolidated Financial Statements

### Year Ending December 31, 2018

#### 2. Summary of Significant Accounting Policies, continued

##### *Use of Estimates*

The preparation of consolidated 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 amounts reported in the financial statements and accompanying notes. Accordingly, actual results could differ from those estimates. A significant estimate subject to change in the near future is fair value of investments, see **Note 4**.

##### *Contributions*

Contributions are recognized when a donor gives or makes a promise to give to the Foundation that is, in substance, unconditional and non-reciprocal. Unconditional promises to give that are expected to be collected within one year are recorded at estimated net realizable value. Unconditional promises to give that are expected to be collected in future years are recorded at the present value of their estimated future cash flows. The discounts on these amounts are computed using risk-free interest rates applicable to the years in which the promises are received. Amortization of the discounts is included in unrestricted contribution revenue. Conditional promises to give are not included as support until the conditions are substantially met.

##### *Royalty Income*

Royalty income is recognized and recorded as received by the Foundation.

##### *Property and Equipment*

Fixed assets consisting of furniture, fixtures and office equipment are recorded at cost on date of purchase or estimated fair market value at the date of the gift. Expenditures over \$500 and with a useful life of greater than one year are capitalized and depreciated over their useful lives (ranging from 5 to 10 years) of the fixed assets. Expenditures less than \$500 or with a useful life less than one year are charged to expense as they are incurred.

Property consists of the costs to construct the Foundation's corporate office building which was completed during 2018. The cost of the building and any future improvements to the building are capitalized and depreciated over the estimated useful life of 40 years.

Land improvements consist of a parking facility and landscaping. Land improvements are recorded at cost on date of purchase. Expenditures over \$500 and with a useful life of greater than one year are capitalized and depreciated over their useful lives (ranging from 15 to 20 years). Expenditures less than \$500 or with a useful life of less than one year are charged to expense as incurred.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets. Depreciation expense for the year ending December 31, 2018 was \$102,137.



# Permian Basin Area Foundation

## Notes to Consolidated Financial Statements

### Year Ending December 31, 2018

#### 2. Summary of Significant Accounting Policies, continued

##### *Investments*

In accordance with FASB ASC 958 *Not-for-Profit Entities – Overall*, the Foundation records all investments in equity securities with readily determinable fair values and all investments in fixed income securities at fair value, as defined by ASC Topic 820 *Fair Value Measurements and Disclosures – Overall*.

Investment income, including interest and dividends, is recognized as earned.

Realized gains or losses on investments represent the difference between the book value of investments and the sales proceeds. Unrealized gains or losses represent the difference between the beginning of year value or purchase date during the year and end of year value. The carrying amount of investments approximates fair value.

Net investment return is reported in the Statement of Activities and consists of interest and dividend income, realized and unrealized gains and losses, less external and any direct internal investment expenses.

##### *Fair Value Measurements*

The Foundation complies with FASB ASC Topic 820 *Fair Value Measurements and Disclosures – Overall* (FASB ASC 820). FASB ASC 820 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP) and expands disclosures about fair value measurements.

##### *Funds Held for Agencies*

Funds held for agencies represent assets transferred to the Foundation for investment management or other specified purposes by various non-profit organizations and other entities that have designated themselves as the beneficiaries in reciprocal transactions.

The Foundation maintains variance power and legal ownership of these funds, and as such, reports the funds as assets of the Foundation. However, in accordance with FASB ASC Topic 958 *Not-for-Profit Entities – Overall*, a liability has been established for the fair value of these funds, which is generally equivalent to the present value of future payments expected to be made to the not-for-profit organizations and others that are the ultimate recipients.

##### *Donated Services*

Many individuals volunteer their time and perform a variety of tasks to support the Foundation. The value of volunteer services donated to the Foundation is not readily measurable and, accordingly, is not included as support and revenues and expenses in the accompanying consolidated financial statements.



# Permian Basin Area Foundation

## Notes to Consolidated Financial Statements

### Year Ending December 31, 2018

#### 2. Summary of Significant Accounting Policies, continued

##### *Functional Expense Allocations*

The costs of providing the various programs and other activities have been summarized on a functional basis in the Statement of Activities. **Note 9** provides the natural classification detail of expense by function. Expenses relating to more than one function are allocated to program service, general and administrative and fundraising costs based on employee time records or other appropriate allocation factors. General and administrative expenses include those expenses that are not directly identifiable with any other specific function but provide for the overall support and direction of the Foundation.

##### *Grants, Scholarships and Program Services*

Grants, scholarships and program services represent amounts awarded to various not-for-profit organizations to assist with funding of general operations, capital improvements or programs. Scholarships are awarded to eligible area applicants to assist with postsecondary education. Grants and Scholarships program services also include the direct cost of conducting the grants and scholarships programs. Grants and scholarships payable consist of unconditional amounts awarded, but not paid, to not-for-profit organizations.

Community education includes general outreach to advance the mission of the Foundation and philanthropy in West Texas. Such activities include providing advice to nonprofits on best management practices and capacity building, making reports to nonprofit boards about endowments, and conducting educational events for nonprofits.

##### *Income Taxes*

The Foundation is exempt from federal income tax under section 501(a) as a Foundation described in section 501(c)(3) of the Internal Revenue Code (the Code), and has been determined not to be a private foundation under section 509(a) of the Code. As a result, income taxes are not included in the Foundation's consolidated financial statements.

The Foundation complies with FASB ASC Topic 740, *Accounting for Uncertainty in Income Taxes* (Topic 740), which addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under this guidance, the Foundation may recognize the tax benefit from an uncertain tax position only if it is more-likely-than-not that the tax position will be sustained on examination by taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such position are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. The guidance on accounting for uncertainty in income taxes also addresses de-recognition, classification, interest and penalties on income taxes, and accounting in interim periods

Management evaluated the Foundation's tax positions and concluded that the Foundation has taken no uncertain tax positions that require adjustment to the consolidated financial statements to comply with the provisions of this guidance. With few exceptions, the Foundation is no longer subject to income tax examinations by the U.S. federal tax authorities for years ending before December 31, 2015.

##### *Subsequent Events*

Management of the Foundation has evaluated subsequent events through April 26, 2019, the date the financial statements were available to be issued. See **Note 15** for management's evaluation of subsequent events.



# Permian Basin Area Foundation

## Notes to Consolidated Financial Statements

### Year Ending December 31, 2018

#### 2. Summary of Significant Accounting Policies, continued

##### *Recent Accounting Pronouncements*

In August 2016, the FASB issued ASU 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*, which simplifies and improves how a not-for-profit organization classifies its net assets, as well as the information it presents in the financial statements and notes about its liquidity, financial performance and cash flows. Among other changes, the ASU replaces the three current classes of net assets with two new classes, “net assets with donor restrictions” and “net assets without donor restrictions”, and expands disclosures about the nature and amount of any donor restrictions. ASU 2016-14 is effective for annual periods beginning after December 15, 2017 and interim periods within fiscal years beginning after December 15, 2018, with early adoption permitted. The Foundation adopted ASU 2016-14 beginning January 1, 2018.

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement*, which modifies to disclosure requirements for fair value measurements by removing, modifying, or adding certain disclosures. ASU 2018-13 is effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. An entity is permitted to early adopt any removed or modified disclosures and delay adoption of the additional disclosures until their effective date. The Foundation early adopted ASU 2018-13 for the year ending December 31, 2018. All modifications resulting from the early adoption by the Foundation are reflected in **Note 4**.

In June 2018, The FASB issued ASU 2018-08, *Not-for-Profit Entities (Topic 958): Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. ASU 2018-08 clarifies the guidance for evaluating whether a transaction is reciprocal (i.e., an exchange transaction) or nonreciprocal (i.e., a contribution) and for distinguishing between conditional and unconditional contributions. The ASU also clarifies the guidance used by entities other than not-for-profits to identify and account for contributions made. The ASU has different effective dates for resource recipients and resource providers. Where the organization is the resource recipient, the ASU is applicable to contributions received for annual periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019. Where the organization is a resource provider, the ASU is effective for annual periods beginning after December 15, 2019 and interim periods within annual periods beginning after December 15, 2020. Early adoption is permitted. The Foundation is currently evaluating the impact of the adoption of this guidance on its consolidated financial statements. The adoption of ASU 2018-08 is not expected to have a material impact on the Foundation’s consolidated financial statements.



# Permian Basin Area Foundation

## Notes to Consolidated Financial Statements

### Year Ending December 31, 2018

#### 3. Investments

Securities and other investments are managed by various investment managers approved by the Foundation. The majority of investments are held under a master custodial arrangement with a financial institution. Investments are stated at fair value and consist of the following at December 31, 2018:

Cash equivalents	\$ 13,032,067
Bonds – tax exempt	2,832,638
Bonds – government agencies	6,640,854
Bonds – corporate	3,487,505
Bonds – collateralized mortgage obligations	815,657
Equities – foreign	10,190,968
Equities – domestic	62,701,545
Equity funds	42,187,503
Bond funds	<u>8,486,121</u>
Total Investments, at fair value	<u>\$ 150,374,858</u>

#### 4. Fair Value Measurements

The Foundation complies with FASB ASC Topic 820-10, *Fair Value Measurements* (FASB ASC 820-10), which provides a framework for measuring fair value under generally accepted accounting principles. FASB ASC 820-10 applies to all financial instruments that are being measured and reported on a fair value basis. As defined in FASB ASC 820-10, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In determining fair value, the Foundation uses various methods including market, income and cost approaches. Based on these approaches, the Foundation often utilizes certain assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and/or the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated, or generally unobservable inputs. The Foundation utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. The Foundation also complies with the provisions of FASB ASC 820-10 related to non-financial assets and liabilities if recognized or disclosed in the financial statements at least annually.

Based on the observability of the inputs used in the valuation techniques the Foundation is required to provide the following information according to the fair value hierarchy. The fair value hierarchy ranks the quality and reliability of the information used to determine fair values. Financial assets and liabilities carried at fair value will be classified and disclosed in one of the following three categories:

- Level 1: Quoted market prices in active markets for identical assets or liabilities. Valuations for assets and liabilities traded in active exchange markets, such as the New York Stock Exchange. Level 1 also includes U.S. Treasury and federal agency securities and federal agency mortgage-backed securities, which are traded by dealers or brokers in active markets. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.
- Level 2: Observable market based inputs or unobservable inputs that are corroborated by market data. Valuations for assets and liabilities traded in less active dealer or broker markets. Valuations are obtained from third party pricing services for identical or similar assets or liabilities.



# Permian Basin Area Foundation

## Notes to Consolidated Financial Statements

### Year Ending December 31, 2018

#### 4. Fair Value Measurements, continued

Level 3: Unobservable inputs that are not corroborated by market data. Valuations for assets and liabilities that are derived from other valuation methodologies, including option pricing models discounted cash flow models and similar techniques, and not based on market exchange, dealer, or broker traded transactions. Level 3 valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets or liabilities.

In determining the appropriate levels, the Foundation performs a detailed analysis of the assets and liabilities that are subject to FASB ASC 820-10. At each reporting period, all assets and liabilities for which the fair value measurement is based on significant unobservable inputs are classified as Level 3.

While the Foundation believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date. During the years ended December 31, 2018, there were no changes to the Foundation's valuation techniques that had, or are expected to have, a material impact on its consolidated financial position or results of operations.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

- The carrying amount of *cash equivalents* approximates fair value because of the short-term nature and liquidity of the financial instrument.
- *Bonds* are based on the present value of the stream of cash flows it is expected to generate and the active market of similar bonds being traded in the marketplace.
- *Equities* are valued at the closing price on the last business day of the year.
- Fair value of *bequests receivable* is determined based on the market value of the underlying assets. Fair value at December 31, 2018 was determined based on a certified appraisal of real estate in an active market.
- Fair value of *beneficial interests in remainder, lead and royalty trusts* is calculated by determining the present value of the future cash flows.
- Fair value of *beneficial interests in perpetual trusts* is calculated based on the fair value of the underlying assets in the trust as determined by the third party trustee. The third party trustee controls the investments in the trust and makes all management and investment decisions.
- Fair value of the *oil and gas royalties* at December 31, 2018 was estimated using the trailing 60 months of net revenue, an industry accepted valuation method.



Permian Basin Area Foundation  
Notes to Consolidated Financial Statements  
Year Ending December 31, 2018

**4. Fair Value Measurements, continued**

The table below presents the balances of assets measured at fair value on a recurring basis by level within the hierarchy.

*Fair Value Measurements at December 31, 2018 Using*

<i>Assets</i>	<i>Totals</i>	<i>Quoted Prices in Active Markets for Identical Assets (Level 1)</i>	<i>Significant Other Observable Inputs (Level 2)</i>	<i>Significant Unobservable Inputs (Level 3)</i>
Investments:				
Cash equivalents	\$ 13,032,067	\$ 13,032,067	\$ 0	\$ 0
Bonds – tax exempt	2,832,638	2,832,638	0	0
Bonds – government agency	6,640,854	6,640,854	0	0
Bonds – corporate	3,487,505	3,487,505	0	0
Bonds – collateralized mortgage obligations	815,657	0	815,657	0
Equities – foreign	10,190,968	10,190,968	0	0
Equities – domestic	62,701,545	62,701,545	0	0
Equity funds	42,187,503	42,187,503	0	0
Bond funds	8,486,121	8,486,121	0	0
Total Investments	150,374,858	149,559,201	815,657	0
Bequest receivable	1,500,000	0	1,500,000	0
Beneficial interest in remainder trust	1,624,256	0	0	1,624,256
Beneficial interest in lead trust	1,090,588	0	0	1,090,588
Beneficial interest in royalty trust	3,358,697	0	0	3,358,697
Beneficial interest in perpetual trust	44,917	0	0	44,917
Oil and gas royalties	16,660,243	0	0	16,660,243
Limited partnership interest	176,670	0	0	176,670

*Level 3 Asset Enhanced Disclosure*

During 2018, the Foundation received a new *beneficial interest in royalty trust* as a result of a bequest, which is classified as Level 3 in the fair value hierarchy.



# Permian Basin Area Foundation

## Notes to Consolidated Financial Statements

### Year Ending December 31, 2018

#### 5. Retirement Plans

The Foundation provides a Simplified Employee Pension Plan (SEP), to which a portion of each qualified participant's salary is contributed by the Foundation. Contributed funds vest immediately to the participant, who self directs the investment of the funds. The amount contributed to the SEP by the Foundation during 2018 was \$70,641, and is included in personnel costs in the functional expenses, see **Note 9**.

The Foundation also sponsors a defined contribution 403(b) plan that allows employees to defer a portion of their compensation by contributing to the plan. Investments in an employee's 403(b) account are also directed by the participant.

#### 6. Risks and Uncertainties

The Foundation invests a substantial portion of its assets in various investment securities. Investment securities, in general, are exposed to various risks, such as interest rate fluctuations and overall market volatility. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the values of investment securities will occur in the near term and those changes could materially affect the amounts reported in the consolidated financial statements.

#### 7. Agency Transfers Subject to FASB ASC 958 (formerly SFAS 136)

The Foundation follows the provisions of FASB ASC 958, which establishes standards for transactions in which the Foundation accepts a contribution from a donor and agrees to transfer those assets, the return on investment of those assets, or both, to another entity that is specified by the donor.

FASB ASC 958 specifically requires that, if a not-for-profit organization establishes a fund at a community foundation with its own funds and specifies itself or one of its affiliated organizations as the beneficiary of the fund, the community foundation must account for the transfer of such assets and the activity associated with those assets as a liability.

The Foundation maintains variance power, as described in the Articles of Incorporation of the Foundation, and legal ownership over these funds and, as such, continues to report the funds as assets of the Foundation. Variance power assures donors that if the charitable purpose of their contribution becomes impractical or impossible, the distributions will be directed to similar purposes in the community.

A liability for agency transfers subject to FASB ASC 958 has been established in the consolidated statement of financial position for the fair value of \$18,000,524 on December 31, 2018. All financial activity for year ending December 31, 2018, related to these assets is also segregated from the consolidated statement of activities and has been reclassified to the liability.

The following table summarizes activity in such funds during the years ending December 31, 2018:

Funds held for agencies at January 1	\$ 19,334,706
Contributions received for agencies	1,249,705
Investment return, net	(1,476,106)
Amounts granted to agencies	(898,011)
Administrative fees	(197,990)
Funds reclassified to (from) agency	<u>(11,780)</u>
Funds held for agencies at December 31	<u>\$ 18,000,524</u>



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**8. Net Assets**

During the year ending December 31, 2018, the Foundation had the following endowment-related activities:

	<i>2018</i>		
	<i>Without Donor Restrictions</i>	<i>With Donor Restrictions</i>	<i>Total</i>
Endowment net assets, beginning of year	\$ 130,709,372	\$ 11,056,064	\$ 141,765,436
Investment return, net	(9,412,355)	399,745	(9,012,610)
Contributions	8,335,858	3,358,697	11,694,555
Amounts appropriated for expenditure	(4,597,698)	0	(4,597,698)
Other changes	9,945,363	(11,350)	9,934,013
Changes in endowment net assets	<u>4,271,168</u>	<u>3,747,092</u>	<u>8,018,260</u>
Endowment net assets, end of year	<u>\$ 134,980,540</u>	<u>\$ 14,803,156</u>	<u>\$ 149,783,696</u>

As of December 31, 2018, the composition of the Foundation's endowment funds was as follows:

	<i>2018</i>		
	<i>Without Donor Restrictions</i>	<i>With Donor Restrictions</i>	<i>Total</i>
Donor Restricted Endowment Funds:			
Restricted for the passage of time	\$ 0	\$ 6,073,541	\$ 6,073,541
Restricted in perpetuity for endowment	0	8,729,615	8,729,615
Total Donor Restricted Endowment Funds	<u>0</u>	<u>14,803,156</u>	<u>14,803,156</u>
Board Designated Endowment Funds:			
Undesignated	4,986,669	0	4,986,669
Scholarship	13,773,475	0	13,773,475
Donor Advised	27,162,321	0	27,162,321
Donor Designated	15,823,159	0	15,823,159
Field of Interest	<u>73,234,916</u>	<u>0</u>	<u>73,234,916</u>
Total Board Designated	<u>134,980,540</u>	<u>0</u>	<u>134,980,540</u>
Total Endowment Funds	<u>\$ 134,980,540</u>	<u>\$ 14,803,156</u>	<u>\$ 149,783,696</u>



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**8. Net Assets, continued**

In addition to endowment net assets, the Foundation also manages other non-endowed funds. The following tables summarize all Foundation net assets as of December 31, 2018:

	<i>2018</i>		
	<i>Without Donor Restrictions</i>	<i>With Donor Restrictions</i>	<i>Total</i>
Endowment Funds	\$ 134,980,540	\$ 14,803,156	\$ 149,783,696
Non-Endowment Funds with Donor Restrictions:			
Field of Interest – restricted for the passage of time	0	1,500,000	1,500,000
Scholarship – restricted for specified purpose	0	3,000,000	3,000,000
Non-Endowment Funds without Donor Restrictions:			
Donor Advised	2,365,436	0	2,365,436
Field of Interest	2,429,798	0	2,429,798
Donor Designated	1,000	0	1,000
Scholarship	162,126	0	162,126
Administration Fund	<u>6,343,757</u>	<u>0</u>	<u>6,343,757</u>
Total Net Assets	<u>\$ 146,282,657</u>	<u>\$ 19,303,156</u>	<u>\$ 165,585,813</u>



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**9. Functional Expenses**

The table below represents expenses by both their nature and their function for the year ending December 31, 2018:

	<i>Program Activities</i>		<i>Supporting Activities</i>		<i>Total Expenses</i>
	<i>Grants and Scholarships</i>	<i>Community Education</i>	<i>General and Administrative</i>	<i>Fund-Raising</i>	
Grants and Scholarships	\$ 6,052,660	\$ 0	\$ 0	\$ 0	\$ 6,052,660
Personnel Costs	223,187	41,375	689,229	59,788	1,013,579
Occupancy and Office Expense	51,973	8,759	165,300	15,418	241,450
Information Technology	20,368	1,746	58,594	2,620	83,328
Contract Services	1,570	0	339,607	0	341,177
Marketing and Communications	8,651	4,143	11,143	17,838	41,775
Events and Sponsorships	10,335	1,000	230	25,402	36,967
Conferences and Travel	9,460	1,031	7,708	5,756	23,955
Insurance	6,469	1,176	23,205	64,990	95,840
Board and Committees	823	0	7,772	0	8,595
Dues, Memberships, and Subscriptions	1,453	943	2,193	1,351	5,940
Cost of Benefit to Donors	0	0	0	35,876	35,876
Other	6,558	0	81,198	0	87,756
<b>Total Functional Expenses</b>	<b>\$ 6,393,507</b>	<b>\$ 60,173</b>	<b>\$ 1,386,179</b>	<b>\$ 229,039</b>	<b>\$ 8,068,898</b>



# Permian Basin Area Foundation

## Notes to Consolidated Financial Statements

### Year Ending December 31, 2018

#### 10. Liquidity

Financial assets available for grants, scholarships and other expenses within one year of the Statement of Financial Position date comprise the following at December 31, 2018:

Cash and cash equivalents	\$	3,909,522
Long-term investments made available for current use		10,755,262
	\$	14,664,784

As part of the Foundation's liquidity management, financial assets are structured to be available as general expenditures, liabilities and other obligations become due. The Foundation invests cash in excess of daily requirements in short-term investments and money market funds.

The amounts reflected above in cash and cash equivalents are available for the Foundation's general expenditures, liabilities and other obligations, as well as for grant and scholarship awards from non-endowed grantmaking funds. Included in Long-term investments made available for current use is \$2,592,888 also available for the Foundation's general expenditures, liabilities and other obligations, as well as for grant and scholarship awards from non-endowed grantmaking funds.

Endowed funds consist of donor restricted endowments and board designated endowments. Amounts held in donor restricted endowments for a specific purpose are not available for general expenditure.

As described in **Note 2**, during 2018 the Foundation's Board of Governors approved a distribution policy of 4.0% for 2019. A spendable amount of \$6,293,910 will be made available for grantmaking from these endowments during 2019. In addition, \$1,868,464 remained as spendable as a result of previous years available-to-spend amounts which had not been distributed as of December 31, 2018. Although the Foundation does not intend to spend from its board designated endowment funds, other than amounts appropriated per the Board's annual distribution policy approval, these amounts could be made available if necessary.

#### 11. Beneficial Interest in Remainder Trust

The Foundation received notice during 2007 that it is the sole residual beneficiary of certain charitable remainder trusts, one of which is of material value to the Foundation. Upon the death of this trust's beneficiary, the remaining principal and income in the trust will be distributed to the Foundation. The future interest in the trust as of December 31, 2018, of \$1,624,256 has been recorded at estimated net present value considering estimated future trust earnings and expected future beneficiary distributions, assuming an annual rate of return for the year ended December 31, 2018, of 9.96%, and assuming the trust terminates in the year 2036.



# Permian Basin Area Foundation

## Notes to Consolidated Financial Statements

### Year Ending December 31, 2018

#### **12. Beneficial Interest in Lead Trust**

The Foundation received notice during 2012 that it is the sole beneficiary of a charitable lead trust. During each year of the trust, the Foundation will receive an annuity equal to seven percent of the initial fair market value of the trust assets. The trust will continue for a term of eighteen years. During 2016, the financial account for the charitable lead trust was established, and the future interest in the trust has been recorded at December 31, 2018 at the net present value of the estimated future payments in the amount of \$1,090,588, assuming a discount rate of 8%.

#### **13. Beneficial Interest in Royalty Trust**

The Foundation received notice during 2018 that it is the sole residual beneficiary of a royalty trust. Upon the death of both primary beneficiaries of the trust, the remaining principal and income in the trust will be distributed to the Foundation. The future interest in the trust as of December 31, 2018, of \$3,358,697 has been recorded at estimated net present value considering estimated future trust earnings and expected future beneficiary distributions, assuming an annual rate of return on investments for the year ended December 31, 2018, of 1.48%, additional annual royalty income of \$995,426, and assuming the trust terminates in the year 2040.

#### **14. Major Contributors**

Contributions, in the form of a bequest, from one major donor totaled \$9,112,666, or 55% of total contributions received for the year ending December 31, 2018.

#### **15. Subsequent Events**

In January 2018, the Foundation entered into a contract with a firm to market its oil and gas royalty interests held in the names of certain of its component funds. The contract does not obligate the Foundation to sell these assets. However, if significant value can be realized with potential sale(s), the Board of Governors of the Foundation may authorize sale(s) given recent trends in oil and gas transactions. A commission equal to 4% of the proceeds of any sale will be paid to the marketing firm.

On March 21, 2019, the Foundation entered into an agreement to sell a portion of its oil and gas royalty interests for \$3,900,000. These interests earned average monthly revenue during 2018 of approximately \$25,000.

On April 9, 2019, the Foundation entered into a separate agreement to sell another portion of its oil and gas royalty interests for \$8,273,547. These interests earned average monthly revenue during 2018 of approximately \$64,000.

The Foundation is currently evaluating how the sale of these oil and gas royalty interests will impact the oil and gas royalty interests value for 2019, and as the interests sold represent a significant portion of the Foundation's oil and gas royalty interests, the value of the oil and gas royalty interests reflected in the Statement of Financial Position after these sales is expected to be materially lower than the value reflected as of December 31, 2018.

