



THE WALLACE FOUNDATION

Financial Statements

December 31, 2018 and 2017

(With Independent Auditors' Report Thereon)



KPMG LLP
345 Park Avenue
New York, NY 10154-0102

Independent Auditors' Report

The Board of Directors
The Wallace Foundation:

We have audited the accompanying financial statements of The Wallace Foundation, which comprise the balance sheets as of December 31, 2018 and 2017, and the related 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 financial statements in accordance with U.S. generally accepted accounting principles; 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.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. 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 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 auditors' 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 entity'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 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 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 financial position of The Wallace Foundation as of December 31, 2018 and 2017, and changes in its net assets and its cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.



Emphasis of a Matter

As discussed in note 2 to the financial statements, in 2018, The Wallace Foundation adopted Accounting Standard Update No. 2016-14, Not-For-Profit Entities (Topic 958): *Presentation of Financial Statements of Not-for-Profit Entities*. Our opinion is not modified with respect to this matter.

KPMG LLP

June 12, 2019

THE WALLACE FOUNDATION

Balance Sheets

December 31, 2018 and 2017

Assets	2018	2017
Cash equivalents and cash	\$ 25,217,976	15,819,738
Investments (note 4)	1,434,414,680	1,556,190,750
Other assets and receivables	1,013,936	1,281,156
Fixed assets, net of accumulated depreciation of \$3,545,774 in 2018 and \$3,310,824 in 2017	<u>1,034,792</u>	<u>922,560</u>
Total assets	<u>\$ 1,461,681,384</u>	<u>1,574,214,204</u>
Liabilities and Net Assets		
Liabilities:		
Accrued expenses and other payables	\$ 2,293,642	3,285,329
Grants payable (note 6)	32,014,428	26,260,379
Deferred liabilities (note 7)	<u>6,416,762</u>	<u>9,210,065</u>
Total liabilities	40,724,832	38,755,773
Net assets – without donor restrictions	<u>1,420,956,552</u>	<u>1,535,458,431</u>
Total liabilities and net assets	<u>\$ 1,461,681,384</u>	<u>1,574,214,204</u>

See accompanying notes to financial statements.

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Statements of Activities

Years ended December 31, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Investment return:		
Investment income (loss)	\$ (26,161,641)	220,635,028
Less: investment expenses	<u>(5,027,160)</u>	<u>(2,730,810)</u>
Total investment return (loss), net	<u>(31,188,801)</u>	<u>217,904,218</u>
Expenses:		
Grants and related activities	70,483,055	67,346,543
Operating expenses	<u>12,830,023</u>	<u>12,475,723</u>
Total expenses	<u>83,313,078</u>	<u>79,822,266</u>
Change in net assets	(114,501,879)	138,081,952
Net assets – without donor restrictions:		
Beginning of year	<u>1,535,458,431</u>	<u>1,397,376,479</u>
End of year	<u>\$ 1,420,956,552</u>	<u>1,535,458,431</u>

See accompanying notes to financial statements.

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Statements of Cash Flows

Years ended December 31, 2018 and 2017

	2018	2017
Cash flows from operating activities:		
Change in net assets	\$ (114,501,879)	138,081,952
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Unrealized losses (gains) on investments	114,848,973	(136,731,203)
Realized (gains) on investments	(71,507,002)	(76,948,181)
Depreciation	293,209	303,802
Changes in operating assets and liabilities:		
Accrued investment income	(16,872)	(159,130)
Other assets and receivables	267,220	(854,628)
Accrued expenses and other payables	(991,687)	1,653,022
Grants payable	5,754,049	414,527
Deferred liabilities	(2,793,303)	2,583,798
Net cash used in operating activities	<u>(68,647,292)</u>	<u>(71,656,041)</u>
Cash flows from investing activities:		
Sales of investments	269,780,088	371,098,105
Purchases of investments	(191,329,117)	(299,308,561)
Purchases of fixed assets	(405,441)	—
Net cash provided by investing activities	<u>78,045,530</u>	<u>71,789,544</u>
Net increase in cash equivalents and cash	9,398,238	133,503
Cash equivalents and cash at beginning of year	<u>15,819,738</u>	<u>15,686,235</u>
Cash equivalents and cash at end of year	<u>\$ 25,217,976</u>	<u>15,819,738</u>

See accompanying notes to financial statements.

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Notes to Financial Statements

December 31, 2018 and 2017

(1) Nature of Operations

The Wallace Foundation (the Foundation) is the philanthropic legacy of DeWitt and Lila Acheson Wallace, the co-founders of Reader's Digest. The mission of the Foundation is to foster improvements in learning and enrichment for disadvantaged children and the vitality of the arts for everyone. The Foundation seeks to meet two goals simultaneously: on the one hand, to create direct benefits for disadvantaged children and arts audiences while strengthening the organizations that serve them and, on the other hand, to spur beneficial changes for fields as a whole. The Foundation's approach is to identify areas where a gap in knowledge is a barrier to progress in the field, and then work to fill those knowledge gaps through grants for innovation, research, and communication. As a result, in addition to funding the direct delivery of services to the intended beneficiaries and capacity building at grantees, the Foundation gathers and publishes insights useful to policymakers and those who work in the areas where the Foundation concentrates its philanthropy. Today, the Foundation works in four areas: strengthening education leadership to improve student achievement; improving and aligning afterschool, summer and in-school experiences that help underserved children gain social, emotional and academic skills; engaging more young people in arts learning experiences; and building audiences for the arts.

(2) Summary of Significant Accounting Policies

(a) Basis of Accounting

The accounts of the Foundation are maintained on the accrual basis of accounting and in conformity with U.S. generally accepted accounting principles.

(b) Income Taxes

The Foundation is exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code (the Code) and is a private foundation as defined in Section 509(a) of the Code. As required by the Code, the Foundation distributes annually at least 5% of the monthly average of the fair market value of its assets no later than the 12-month period following the end of its fiscal year.

The Foundation recognizes the effects of income tax positions only if those positions are more likely than not to be sustained in the future. The Foundation has concluded that there were no uncertainties to disclose.

(c) Fair Value Measurements

Fair value is defined as the exchange price that would be received to sell an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The fair value hierarchy maximizes the use of observable inputs and minimizes the use of unobservable inputs when measuring fair value. The Foundation uses three levels of inputs to measure fair value:

Level 1: Quoted or published prices in active markets for identical assets. Level 1 assets include debt and equity securities that are traded or published in an active exchange market.

Level 2: Observable inputs other than Level 1 prices such as quoted or published prices for similar assets; prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets.

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Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the asset. Level 3 assets include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

The classification of investments in the fair value hierarchy is not necessarily an indication of the risks, liquidity, or degree of difficulty in estimating the fair value of each investment's underlying assets and liabilities.

Fair value estimates are made at a specific point in time, based on available market information and judgments about the financial instrument, including estimates of timing, amount of expected future cash flows, and the credit standing of the issuer. In some cases, the fair value estimates cannot be substantiated by comparison to independent markets. In addition, the disclosed fair value may not be realized in the immediate settlement of the financial asset. The disclosed fair values do not reflect any premium or discount that could result from offering for sale at one time an entire holding of a particular financial asset.

Potential taxes and other expenses that would be incurred in an actual sale or settlement are not reflected in amounts disclosed.

(d) Investments

Investments in equity securities with readily determinable fair values are reported at fair value based on quoted market prices or published net asset value (NAV). Investments in debt securities are measured using quoted market prices where available. If quoted market prices for debt securities are not available, the fair value is determined using an income approach valuation technique that considers, among other things, rates currently observed in publicly traded markets for debt of similar terms to companies with comparable credit risk, the issuer's credit spread, and illiquidity by sector and maturity.

The Foundation follows the accounting standards of Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Subtopic 820-10-35-59, *Fair Value Measurement and Disclosures – Fair Value Measurements of Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*. This allows for the estimation of the fair value of investments in investment companies for which the investment does not have a readily determinable fair value using NAV per share or its equivalent. Those estimated fair values may differ significantly from the values that would have been used had a ready market for these securities existed.

(e) Fixed Assets

Fixed assets consist of furniture, fixtures, equipment, and leasehold improvements. All assets are depreciated on a straight-line basis over the estimated useful lives of the assets. Computers are depreciated over 3 years, office equipment is depreciated over 5 years, and furniture and fixtures are depreciated over 15 years. Leasehold improvements are depreciated over the life of the lease or the estimated life of the leasehold improvement, whichever is shorter.

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(f) Grants

Grants are reported as an expense and liability of the Foundation when approved by the Foundation's board of directors or the president, under authority delegated by the board of directors, and acknowledgement of grantee terms. Payments due in more than one year are discounted to present value.

(g) Cash Equivalents

Cash equivalents represent short-term investments with original maturities of three months or less at the time of purchase, except for those short-term investments managed by the Foundation's investment managers as part of their long-term investment strategies.

(h) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles 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.

(i) New Accounting Pronouncement

The FASB issued Accounting Standards Update (ASU) 2016-14 Not-for-Profit Entities (Topic 958), Presentation of Financial Statements of Not-for-Profit Entities, which among other things, changes how not-for-profit entities report net asset classes, expenses and liquidity in their financial statements. The significant requirements of ASU 2016-14 include reduction in the number of net asset classes from three to two: with donor restrictions (formerly reported as temporary net assets) and without donor restrictions (formerly reported as unrestricted net assets); the presentation of expenses by their function and their natural classification in one location; and quantitative and qualitative information about the management of liquid resources and availability of financial assets to meet cash needs within one year of the date of the statement of financial position. The Foundation has adopted ASU 2016-14 for the year ending December 31, 2018, and retroactively applied the provisions to 2017.

(j) Reclassifications

Certain amounts from the prior year were reclassified to conform to current year presentation. These reclassifications had no effect on net assets as previously reported.

(3) Liquidity and Availability of Resources

The Foundation monitors the liquidity required to meet its grants and operating expenses on a regular basis while also seeking to generate favorable risk-adjusted returns from its investments. The Foundation's liquidity monitoring focuses on ensuring that sufficient liquidity, including cash and cash equivalents and investments convertible to cash in the next 12 months, is available to meet projected spending based on the Foundation's projected payouts for grants and operating expenses. Despite the large amount of available liquid assets, the Foundation anticipates expenditures to remain consistent and not exceed what is required to support and meet its mandated distribution requirements.

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The following table represents the Foundation's financial assets available for general expenditure, without restrictions limiting their use, within one year of the balance sheet date of December 31, 2018 and 2017:

	2018	2017
Cash and cash equivalents	\$ 25,217,976	15,819,738
Investments convertible to cash in the next 12 months	974,681,975	1,167,391,835
Receivables for investments sold, net	21,383,071	13,125,679
	\$ 1,021,283,022	1,196,337,252

(4) Investments

(a) Fair Value Hierarchy

The following tables present the Foundation's fair value hierarchy for investments, the only financial instruments measured at fair value on an annual basis, as of December 31, 2018 and 2017.

Investments measured using the NAV per share practical expedient are included in the total fair value column only and are not disclosed within the fair value hierarchy levels:

	2018			
	Total fair value	Level 1	Level 2	Level 3
Growth – market stocks:				
Direct ownership:				
International	\$ 63,660,821	63,660,821	—	—
Mutual fund:				
Global	23,542,160	23,542,160	—	—
	87,202,981	87,202,981	—	—
Commingled stock funds:				
United States	100,701,621	100,701,621	—	—
International	52,518,837	52,518,837	—	—
Global	64,529,335	64,529,335	—	—
	217,749,793	217,749,793	—	—
Growth total	304,952,774	304,952,774	—	—
Diversifying – bond funds:				
Mutual fund:				
Global	85,931,083	85,931,083	—	—
Diversifying total	85,931,083	85,931,083	—	—

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	2018			
	Total			
	fair value	Level 1	Level 2	Level 3
Inflation hedges – market:				
Public energy fund	\$ 20,036,771	20,036,771	—	—
Inflation hedges total	<u>20,036,771</u>	<u>20,036,771</u>	<u>—</u>	<u>—</u>
Deflation hedges – fixed income:				
Direct ownership:				
United States government/agency	75,472,140	—	75,472,140	—
Mutual funds:				
United States corporate and other	<u>20,364,049</u>	<u>20,364,049</u>	<u>—</u>	<u>—</u>
Deflation hedges – fixed income total	<u>95,836,189</u>	<u>20,364,049</u>	<u>75,472,140</u>	<u>—</u>
Other:				
Short-term investments	2,745,510	2,745,510	—	—
Equity holdings	1,305,663	1,305,663	—	—
Receivables for investments sold, net	<u>21,383,071</u>	<u>21,383,071</u>	<u>—</u>	<u>—</u>
Total	532,191,061	\$ <u>456,718,921</u>	<u>75,472,140</u>	<u>—</u>
Investments measured using net asset value (or its equivalent):				
Growth – market stocks:				
Commingled stock funds	213,435,864			
Growth – hedge funds:				
Multistrategy	56,494,208			
Long/short equity	148,260,305			
Credit-redeemable	22,406,266			
Credit-nonredeemable	62,505,639			
Growth – private equity funds	236,068,626			
Diversifying – opportunistic:				
Global macro systematic	48,518,922			
Relative Value	21,785,028			
Inflation hedges – market:				
Public energy fund	23,768,592			
Inflation hedges – private:				
Private energy funds	59,760,157			
Private real estate funds	<u>9,220,012</u>			
Total investments	<u>\$ 1,434,414,680</u>			

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Notes to Financial Statements

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	2017			
	Total fair value	Level 1	Level 2	Level 3
Growth – market stocks:				
Direct ownership:				
International	\$ 75,303,747	75,303,747	—	—
Mutual fund:				
Global	28,181,108	28,181,108	—	—
	<u>103,484,855</u>	<u>103,484,855</u>	<u>—</u>	<u>—</u>
Commingled stock funds:				
United States	105,382,213	105,382,213	—	—
International	59,794,165	59,794,165	—	—
Global	89,495,868	89,495,868	—	—
	<u>254,672,246</u>	<u>254,672,246</u>	<u>—</u>	<u>—</u>
Growth total	<u>358,157,101</u>	<u>358,157,101</u>	<u>—</u>	<u>—</u>
Diversifying – bond funds:				
Mutual fund:				
Global	85,434,564	85,434,564	—	—
Diversifying total	<u>85,434,564</u>	<u>85,434,564</u>	<u>—</u>	<u>—</u>
Inflation hedges – market:				
Direct ownership:				
REIT	25,817,650	25,817,650	—	—
Mutual funds:				
United States government/agency	1,144,611	1,144,611	—	—
Public energy fund	26,742,898	26,742,898	—	—
Inflation hedges total	<u>53,705,159</u>	<u>53,705,159</u>	<u>—</u>	<u>—</u>
Deflation hedges – fixed income:				
Direct ownership:				
United States government/agency	67,246,511	—	67,246,511	—
Mutual funds:				
United States corporate and other	165,767	165,767	—	—
Deflation hedges – fixed income total	<u>67,412,278</u>	<u>165,767</u>	<u>67,246,511</u>	<u>—</u>

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Notes to Financial Statements

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	2017			
	<u>Total fair value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Other:				
Short-term investments	\$ 12,640,311	12,640,311	—	—
Accrued investment loss	(16,872)	(16,872)	—	—
Receivables for investments sold, net	<u>13,125,679</u>	<u>13,125,679</u>	<u>—</u>	<u>—</u>
Total	590,458,220	<u>\$ 523,211,709</u>	<u>67,246,511</u>	<u>—</u>
Investments measured using net asset value (or its equivalent):				
Growth – market stocks:				
Commingled stock funds	237,852,350			
Growth – hedge funds:				
Multistrategy	86,308,240			
Long/short equity	142,570,191			
Credit-redeemable	34,764,470			
Credit-nonredeemable	56,577,768			
Growth – private equity funds	216,694,267			
Diversifying – opportunistic:				
Global macro systematic	48,343,623			
Relative Value	20,564,640			
Inflation hedges – market:				
Commodity fund	21,165,873			
Public energy fund	25,286,414			
Inflation hedges – private:				
Private energy funds	65,387,233			
Private real estate funds	<u>10,217,461</u>			
Total investments	<u>\$ 1,556,190,750</u>			

Short-term investments include money market funds, U.S. government securities, and cash managed by the Foundation's investment managers as part of their long-term investment strategies.

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Notes to Financial Statements

December 31, 2018 and 2017

The Foundation did not have any Level 3 investments in 2018. The following tables present reconciliations for all Level 3 assets measured at fair value at December 31, 2017:

	2017						Ending balance
	Beginning balance	Transfer	Realized gain (losses)	Unrealized gain (losses)	Purchases	Settlements	
Diversifying-fixed income – commingled fund	\$ 523,695	—	193,809	(237,031)	—	(480,473)	—
Total	\$ 523,695	—	193,809	(237,031)	—	(480,473)	—

The Foundation recognizes transfers between levels of the fair value hierarchy on the date of the event or change in circumstance that caused the transfer. There were no transfers among Levels 1, 2 or 3 during the years ended December 31, 2018 and 2017.

(b) Strategies of Commingled, Hedge, Inflation Hedge, and Private Equity Funds

The following tables list the investment strategies, redemption terms, and assets for commingled, hedge, inflation hedge, diversifying, and private equity funds measured at fair value as of December 31, 2018 and 2017:

	2018			
	Total fair value	Unfunded commitments	Redemption dates per year	Redemption notice period
Growth – market stocks:				
Commingled stock funds:				
United States	\$ 40,766,910	—	Quarterly/Biennial	60/90 days
Global	38,845,147	—	Quarterly (with lock-up until December 2020)	30 days
International	133,823,807	—	Monthly/Daily	6/30 days
Total	213,435,864	—		
Growth – hedge funds:				
Multistrategy	56,494,208	—	Semi-Annually	60/90 days
Long/short equity	148,260,305	—	Monthly/Quarterly/Annually	45/90 days
Credit – redeemable	22,406,266	—	Annually	60 days
Credit – nonredeemable	62,505,639	19,000,000	None	N/A
Total	289,666,418	19,000,000		

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Notes to Financial Statements

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2018				
	Total fair value	Unfunded commitments	Redemption dates per year	Redemption notice period
Growth – private equity funds	\$ 236,068,626	110,207,752	None	N/A
Diversifying – opportunistic:				
Global macro systematic	48,518,922	—	Monthly	5/30 days
Relative value	21,785,028	—	Quarterly	65 days
Total	<u>70,303,950</u>	<u>—</u>		
Inflation hedges – market:				
Public energy fund	23,768,592	—	Quarterly	60 days
Total	<u>23,768,592</u>	<u>—</u>		
Inflation hedges – private:				
Private energy funds	59,760,157	26,778,327	None	N/A
Private real estate funds	9,220,012	2,331,238	None	N/A
Total	<u>68,980,169</u>	<u>29,109,565</u>		
Total	<u>\$ 902,223,619</u>	<u>158,317,317</u>		

2017				
	Total fair value	Unfunded commitments	Redemption dates per year	Redemption notice period
Growth – market stocks:				
Commingled stock funds:				
United States	\$ 50,243,769	—	Biennial	90 days
Global	26,796,507	—	Quarterly (with lock-up until December 2020)	30 days
International	160,812,074	—	Monthly/Daily	6/30 days
Total	<u>237,852,350</u>	<u>—</u>		
Growth – hedge funds:				
Multistrategy	86,308,240	—	Semi-Annually	60/90 days
Long/short equity	142,570,191	—	Quarterly/Annually	45/60 days
Credit – redeemable	34,764,470	—	Quarterly	60 days
Credit – nonredeemable	56,577,768	5,250,000	None	N/A
Total	<u>320,220,669</u>	<u>5,250,000</u>		

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	2017			
	Total fair value	Unfunded commitments	Redemption dates per year	Redemption notice period
Growth – private equity funds	\$ 216,694,267	87,401,787	None	N/A
Diversifying – opportunistic:				
Global macro systematic	48,343,623	—	Monthly	5/30 days
Relative value	20,564,640	—	Quarterly	65 days
Total	<u>68,908,263</u>	<u>—</u>		
Inflation hedges – market:				
Commodity fund	21,165,873	—	Monthly	30 days
Public energy fund	25,286,414	—	Quarterly	60 days
Total	<u>46,452,287</u>	<u>—</u>		
Inflation hedges – private:				
Private energy funds	65,387,233	28,769,680	None	N/A
Private real estate funds	10,217,461	2,331,238	None	N/A
Total	<u>75,604,694</u>	<u>31,100,918</u>		
Total	<u>\$ 965,732,530</u>	<u>123,752,705</u>		

The following provides details for the investment strategies as of December 31, 2018 listed above:

(i) *Growth – Market Stocks*

Commingled Stock Funds

This includes \$213.4 million invested in five funds that invest in publicly traded common stock.

(ii) *Growth – Hedge Funds*

Multistrategy

This consists of \$56.5 million invested in two hedge funds, of which \$44 million is redeemable by the Foundation and \$12.5 million is invested in private investments that will not be distributed to the Foundation until they are sold by the funds' managers at their discretion as market opportunities arise. These hedge funds invest in equity, fixed income, and derivative investments and vary their investment strategies in response to changing market opportunities. As of December 31, 2018, the Foundation's combined investments in these funds included 12% equity strategies, 8% credit strategies, 28% private investments and 52% cash.

Long/Short Equity

This includes \$148.3 million invested in four hedge funds that invest in publicly traded equity securities using a combination of long and short positions.

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Credit – Redeemable

This includes \$22.4 million invested in a hedge fund that can be redeemed by the Foundation that invests primarily in publicly traded debt securities purchased at discounts to par value, including publicly traded bonds, bank debt, residential and commercial mortgage-backed securities, and other asset-backed securities.

Credit – Nonredeemable

This consists of \$62.5 million invested in four hedge funds with structures similar to private equity that make distributions to investors at the manager's discretion and are expected to fully distribute their assets over the next four to eight years approximately. These funds invest in publicly traded and private debt securities purchased at discounts to par value.

(iii) Growth – Private Equity Funds

This includes \$236.1 million invested in 35 funds that make distributions to investors at the managers' discretion and are expected to fully distribute their assets over the next 10 years approximately. As of December 31, 2018, the Foundation's combined investments in these funds includes 9% in seven primary funds of funds that invest in a diversified portfolio of buyout and venture capital funds, 27% in twelve secondary funds of funds that purchase interests in buyout and venture capital funds on a secondary basis at discounts to NAV, 49% in twelve venture capital funds that invest directly in technology and media companies, and 15% in four buyout funds that invest in specific sectors.

(iv) Diversifying – Opportunistic

Global Macro Systematic

This includes \$48.5 million invested in two hedge funds that invest in strategies that rely on mathematical, algorithmic models that analyze movements in global economic variables or prices. Some of these models seek to predict the impact of these variables on equity, fixed income, currency and commodity markets. Other models seek to identify trends in prices.

Relative Value

This includes \$21.8 million invested in a hedge fund that invests in a range of strategies that analyze spreads between securities that share financial and economic characteristics to identify deviations from historical relationships. These investments benefit when discrepancies in these spreads are recognized by the market.

(v) Inflation Hedges – Market

Public Energy Fund

This includes \$23.8 million invested in a fund that invests on a global basis in the publicly traded common stock of energy companies.

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(vi) *Inflation Hedges – Private*

Private Energy Funds

This consists of \$59.8 million in eleven funds that make distributions to investors at the managers' discretion and are expected to fully distribute their assets over the next 10 years approximately. As of December 31, 2018, the Foundation's combined investments in these funds included 9% in three private energy funds of funds that invest in diversified portfolios of direct private energy funds and 91% in eight direct private energy funds that invest in companies that acquire or develop natural resource reserves, power generation facilities, and energy infrastructure assets.

Private Real Estate Funds

This includes \$9.2 million invested in two funds that make distributions to investors at the managers' discretion and are expected to fully distribute their assets over the next 10 years approximately. These funds invest directly in real estate properties that are not traded on public markets.

(5) Natural and Functional Classification of Expenses

The costs of providing program and supporting services of the Foundation have been summarized below. Program expenses pertain to grant making activities such as program design, proposal review, awarding and monitoring, evaluation, and knowledge dissemination. Direct charitable expenses pertain to charitable activities for the benefit of others initiated and conducted, in whole or in part, by the Foundation. Supporting service expenses include costs related to managing the Foundation. Investment expenses reported on the statements of activities excludes certain investment manager fees which are recorded net of investment income on the statements of activities. Investment expenses that are not directly attributable to investment strategy, including staff costs for investment recordkeeping and office costs, are included within supporting services in the table below. Certain operating costs have been allocated, based on headcount, among the program and supporting services benefited.

	2018			2017
	Program	Supporting services	Total	Total
Grants & related activities:				
Grants	\$ 60,431,726	—	60,431,726	57,556,738
Direct charitable activities	10,051,329	—	10,051,329	9,789,805
Total grants & related activities	70,483,055	—	70,483,055	67,346,543
Operating expenses:				
Salaries	4,068,096	2,899,638	6,967,734	6,989,552
Benefits	1,331,758	1,006,825	2,338,583	2,357,200
Consultants	597,694	259,084	856,778	544,576
Rent, net of amortization	540,156	477,830	1,017,986	1,004,439
Other occupancy costs	204,332	180,755	385,087	399,767
Information technology	245,129	205,624	450,753	339,535
Insurance	54,936	48,598	103,534	103,468

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	2018			2017
	Program	Supporting services	Total	Total
Travel & meetings	\$ 300,417	97,047	397,464	414,968
Subscription, dues and fees	9,110	9,785	18,895	18,415
Depreciation	155,580	137,629	293,209	303,803
Total operating expenses	<u>7,507,208</u>	<u>5,322,815</u>	<u>12,830,023</u>	<u>12,475,723</u>
Total expenses	<u>\$ 77,990,263</u>	<u>5,322,815</u>	<u>83,313,078</u>	<u>79,822,266</u>

(6) Grants Payable

At December 31, 2018 and 2017, grants scheduled to be paid in future years are as follows:

	2018	2017
Year:		
2018	\$ —	18,551,462
2019	24,225,585	5,343,767
2020	7,147,797	2,125,000
2021	939,930	545,000
2022	200,000	—
	<u>32,513,312</u>	<u>26,565,229</u>
Discount to present value (based on interest rates from 1.18% to 2.87% and 0.91% to 1.93% for 2018 and 2017, respectively)	<u>(498,884)</u>	<u>(304,850)</u>
	<u>\$ 32,014,428</u>	<u>26,260,379</u>

(7) Deferred Liabilities

At December 31, 2018 and 2017, deferred liabilities consisted of the following:

	2018	2017
Federal excise tax (note 8)	\$ 5,754,789	8,256,503
5 Penn Plaza landlord incentives	<u>661,973</u>	<u>953,562</u>
	<u>\$ 6,416,762</u>	<u>9,210,065</u>

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(8) Federal Excise Tax

As a private foundation, the Foundation is normally subject to a federal excise tax equal to 2% of its net investment income for tax purposes. However, under Section 4940(e) of the Code, this tax is reduced to 1% if certain conditions are met. The Foundation's current taxes are estimated at 1% of net investment income for December 31, 2018 and 2017.

The Foundation records a liability for deferred federal excise tax at the 2% rate on the total unrealized appreciation in the fair value of investments. The federal excise tax will be paid as realized gains are reported for tax purposes. The unrealized (losses)/gains on investments are reported net of the deferred federal excise tax (credit)/expense of (\$2,501,714) and \$2,805,694 for the years ended December 31, 2018 and 2017, respectively, on the statements of activities.

(9) Lease Commitments

The Foundation occupies office space under a lease agreement expiring in 2021. In December 2018, the Foundation entered in to a lease agreement, expiring in 2034, for new office space that will be occupied during the 2019 fiscal year.

The Foundation's contractual lease commitments are as follows:

Year:	
2019	\$ 1,777,000
2020	2,703,000
2021	1,774,000
2022	1,588,000
2023	1,588,000
2024 and beyond	<u>18,768,000</u>
	\$ <u>28,198,000</u>

During the years ended December 31, 2018 and 2017, rent expense, including escalations, was \$1,017,986 and \$1,004,438, respectively.

(10) Pension Plans

The Foundation provides a defined-contribution retirement plan for all eligible employees, whereby the Foundation contributes 15% of a participant's eligible earnings on an annual basis. In addition, the Foundation provides a supplemental executive retirement plan for the benefit of certain eligible employees. Total pension expense for the years ended December 31, 2018 and 2017 was \$1,257,760 and \$1,192,950, respectively.

(11) Subsequent Events

The Foundation evaluated events subsequent to the balance sheet date of December 31, 2018 through June 12, 2019, which was the date the financial statements were available to be issued, and determined there were no additional matters that are required to be disclosed.