

THE ZELLERBACH FAMILY FOUNDATION

DECEMBER 31, 2013 AND 2012

INDEPENDENT AUDITORS' REPORT

AND

FINANCIAL STATEMENTS

The Zellerbach Family Foundation

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Independent Auditors' Report

THE BOARD OF DIRECTORS
THE ZELLERBACH FAMILY FOUNDATION
San Francisco, California

Report on the Financial Statements

We have audited the accompanying financial statements of **ZELLERBACH FAMILY FOUNDATION** which comprise the statements of financial position as of December 31, 2013 and 2012, and the related statements of activities and changes in net assets, 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 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.

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 of 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 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 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.

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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 Zellerbach Family Foundation as of December 31, 2013 and 2012, and the results of its activities and changes in net assets, and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Hood & Strong LLP

San Francisco, California
June 30, 2014

The Zellerbach Family Foundation

Statements of Financial Position

<i>December 31,</i>	2013	2012
Assets		
Cash and equivalents	\$ 962,976	\$ 2,280,157
Investments - at fair value	133,024,543	122,791,289
Other assets, net	135,816	160,730
Total assets	\$ 134,123,335	\$ 125,232,176
Liabilities and Net Assets		
Liabilities:		
Grants payable	\$ 735,000	\$ 615,000
Accounts payable and accrued expenses	214,319	171,346
Deferred federal excise taxes	450,835	342,335
Total liabilities	1,400,154	1,128,681
Unrestricted Net Assets	132,723,181	124,103,495
Total liabilities and net assets	\$ 134,123,335	\$ 125,232,176

The accompanying notes are an integral part of these statements.

The Zellerbach Family Foundation

Statements of Activities and Changes in Net Assets

<i>Years ended December 31,</i>	2013	2012
Revenue:		
Investment income:		
Dividends and interest	\$ 722,556	\$ 1,062,501
Net realized and unrealized gain on investments	16,234,918	13,308,199
Investment management and advisory fees	(1,437,260)	(1,278,399)
Net investment income before federal excise taxes	15,520,214	13,092,301
Federal excise tax expense	243,000	253,000
Net investment income	15,277,214	12,839,301
Expenses:		
Grants approved by the Board of Directors	4,943,583	4,524,760
Administrative and grant support expenses	1,713,945	1,568,087
Total expenses	6,657,528	6,092,847
Change in Net Assets	8,619,686	6,746,454
Unrestricted Net Assets - beginning of year	124,103,495	117,357,041
Unrestricted Net Assets - end of year	\$ 132,723,181	\$ 124,103,495

The accompanying notes are an integral part of these statements.

The Zellerbach Family Foundation

Statements of Cash Flows

<i>Years Ended December 31,</i>	2013	2012
Cash Flows from Operating Activities:		
Change in net assets	\$ 8,619,686	\$ 6,746,454
Adjustments to reconcile change in net assets to net cash used by operating activities:		
Net realized and unrealized gain on investments	(16,234,918)	(13,308,199)
Depreciation and amortization	12,169	13,731
Net effect of changes in:		
Other assets	12,745	60,876
Grants payable	120,000	(125,000)
Accounts payable and accrued expenses	42,974	(97,786)
Deferred federal excise taxes	108,500	150,500
Net cash used by operating activities	(7,318,844)	(6,559,424)
Cash Flows from Investing Activities:		
Purchases of investments	(22,724,545)	(15,658,178)
Proceeds from investments	28,726,208	24,175,747
Net cash provided by investing activities	6,001,663	8,517,569
Change in Cash and Equivalents	(1,317,181)	1,958,145
Cash and Equivalents, beginning of year	2,280,157	322,012
Cash and Equivalents, end of year	\$ 962,976	\$ 2,280,157
Supplemental Cash Flow Disclosures		
Cash paid for federal excise taxes	\$ 90,000	\$ 110,000

The accompanying notes are an integral part of these statements.

The Zellerbach Family Foundation

Notes to Financial Statements

Note 1 - Organization:

The Zellerbach Family Foundation (the Foundation) is a private foundation established in 1956 for the purpose of making charitable contributions that contribute toward constructive social change by initiating and investing in efforts that strengthen families and communities. The Foundation's interests generally fall under the following categories: immigrant and refugee issues, strengthening communities, public human service systems, community arts, and youth development in the arts.

The Foundation receives funding for its community arts program from two other foundations as described in Note 2h.

The Foundation's administrative offices are located in San Francisco, California.

Note 2 - Significant Accounting Policies:

a. Basis of Presentation and Description of Net Assets

The Foundation uses the accrual basis of accounting in accordance with U.S. generally accepted principles and reports information regarding its financial position and activities according to their classes of net assets: unrestricted, temporarily restricted and permanently restricted.

Unrestricted Net Assets

The portion of net assets that is neither temporarily restricted nor permanently restricted by donor-imposed stipulations.

Temporarily Restricted Net Assets

The portion of net assets whose use by the Foundation is limited by donor-imposed stipulations that either expire by passage of time or can be fulfilled and removed by actions of the Foundation. At December 31, 2013 and 2012, the Foundation did not have any temporarily restricted net assets.

Permanently Restricted Net Assets

The portion of net assets whose use by the Foundation is limited by donor-imposed stipulations that neither expire by passage of time nor can be fulfilled or otherwise removed by actions of the Foundation. At December 31, 2013 and 2012, the Foundation did not have any permanently restricted net assets.

The Zellerbach Family Foundation

Notes to Financial Statements

b. Cash and Equivalents

Cash and equivalents consist of cash, money market funds, and short-term commercial paper with maturities of three months or less at date of purchase.

c. Investments

The Foundation reports investments at fair value, with changes in unrealized gains and losses reflected in the statements of activities as part of net realized and unrealized gain (loss) on investments. Realized gains and losses resulting from sales of securities are calculated on an adjusted cost based on the trade date for publicly traded investments or upon closing of the transaction for private investments. Dividend and interest income are accrued when earned. The fair value of alternative investments, global and fixed income funds is further described under the fair value measurement policy below.

Investments, in general, are exposed to various risks, such as interest rate risk, credit risk, and overall market volatility. Due to the level of risk associated with certain investments, it is reasonably possible that changes in the values of investments will occur in the near term and that such changes could materially affect the amounts reported in the financial statements.

d. Fair Value Measurements

The Foundation carries certain assets and liabilities at fair value. Fair value is defined as the price that would be received to sell an asset or paid to transfer liability in an orderly transaction between market participants at the measurement date. In addition, the Foundation reports certain investments using the Net Asset Value (NAV) per share as determined by investment managers under the so-called “practical expedient.” The practical expedient allows net asset value per share to represent fair value for reporting purposes when the criteria for using this method are met.

Fair value measurement standards also require the Foundation to classify these financial instruments into a three-level hierarchy, based on the priority of inputs to the valuation technique or in accordance with net asset value practical expedient rules, which allow for either Level 2 or Level 3 reporting depending on lock up and notice periods associated with the underlying funds. The Foundation classifies its financial assets and liabilities according to three levels, and maximizes the use of observable inputs and minimizes the use of unobservable inputs when measuring fair value.

Level 1 - Quoted market prices (unadjusted) in active markets for identical assets or liabilities that the entity has the ability to access at the measurement date.

The Zellerbach Family Foundation

Notes to Financial Statements

Level 2 - Observable inputs other than quoted prices included within Level 1 for the asset or liability, either directly or indirectly.

Level 3 - Unobservable inputs for the asset or liability that are not corroborated by market data.

e. Fair Value of Financial Instruments

The estimated fair value of the Foundation's financial instruments not measured at fair value on a recurring basis (including accounts payable, accrued expenses, and grants payable) approximates their carrying values due to their short length to maturity.

f. Grants

Grants are expensed when the unconditional promise to give is approved by the Board of Directors. Grants are authorized subject to certain restrictions, and failure of the recipients to meet these restrictions may result in cancellations or refunds. Grant refunds are recorded as a reduction of grant expense at the time the grant is refunded to the Foundation.

g. Revenue Recognition

Contributions are recognized as revenue when received or unconditionally promised. The Foundation reports contributions as restricted support if such contributions are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or a purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported as net assets released from restrictions. Temporarily restricted contributions are reported as temporarily restricted support and net assets released from restrictions when the restriction is met in the same period as the contribution is received.

h. Community Arts Program

The Foundation is participating in and administering a collaborative funding initiative with other organizations to support the community arts program to ensure the availability of a wide variety of art experiences, to promote multicultural community art, encourage new artists, and improve the capacity to perform and develop new audiences. Only 501(c)(3) organizations are eligible for grants. The Foundation records amounts received and paid on behalf of the other participating foundations as agency transactions. Therefore, no revenue or expense is recorded for the amounts received from the other participating foundations or for their share of the grants.

The Zellerbach Family Foundation

Notes to Financial Statements

i. Excise Taxes

The Foundation is a private foundation and is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code and from California franchise and/or income taxes under Section 23701(d) of the Revenue and Taxation Code. In addition, the Foundation may be subject to tax on unrelated business income, if any, generated by its investments.

The Foundation is subject to federal excise tax on its investment income. A provision for federal excise tax is accrued. Deferred taxes are recorded on the unrealized gain on investments (see Note 5).

The Foundation follows the guidance of the Financial Accounting Standards Board (FASB) ASC Topic 740 for accounting for uncertainty in income taxes. As of December 31, 2013, management evaluated the Foundation's tax positions and concluded that the Foundation had maintained its tax exempt status and had taken no uncertain tax positions that require adjustment to the financial statements. Therefore, no provision or liability for income taxes has been included in the financial statements. With few exceptions, the Foundation is no longer subject to income tax examinations by federal or state authorities for years before 2010 and 2009, respectively.

j. Concentrations of Credit Risk

Financial instruments, which potentially subject the Foundation to credit risk, consist primarily of cash, cash equivalents, and investments. The Foundation maintains cash and cash equivalents with major financial institutions. Cash equivalents include investments in money market funds and short-term commercial paper. At times, such amounts may exceed FDIC limits. The Foundation's investments have been placed with major financial institutions. The Foundation closely monitors these investments and has not experienced significant credit losses.

k. Use of Estimates

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

The Zellerbach Family Foundation

Notes to Financial Statements

1. Subsequent Events

The Foundation evaluated subsequent events with respect to the financial statement for the year ended December 31, 2013 through June 30, 2014, the date these financial statements were available to be issued and has determined that no adjustments are necessary to the amounts reported in the accompanying financial statements nor have any subsequent events occurred, the nature of which would require disclosure except as described in Note 4.

Note 3 - Investments:

Investments at December 31, 2013 and 2012, consist of the following:

	2013	2012
Cash and cash equivalents	\$ 1,240,146	\$ 1,094,052
Domestic equities and funds	18,109,826	14,764,300
Global equity funds	37,989,191	32,298,172
Alternative equity funds	50,521,388	41,597,851
Inflation protection equities and funds	17,284,568	18,009,079
Fixed income funds	7,879,424	15,027,835
	<hr/>	<hr/>
	\$ 133,024,543	\$ 122,791,289

The Zellerbach Family Foundation

Notes to Financial Statements

Note 4 - Fair Value Measurement and Net Asset Value Disclosure:

Fair Value Disclosures:

The table below presents the balances of assets measured at fair value on a recurring basis at December 31, 2013:

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Cash and cash equivalents	\$ 1,240,146	\$ 1,240,146		
Domestic equities and funds:				
Materials	612,568	612,568		
Industrials	3,836,676	3,836,676		
Consumer	2,021,666	2,021,666		
Energy	1,125,949	1,125,949		
Financials	833,846	833,846		
Information technology	1,944,489	1,944,489		
Healthcare	1,297,339	1,297,339		
Telecommunications	343,324	343,324		
Domestic equity fund	6,093,969		\$ 6,093,969	
Global equity funds:				
Global equity	10,844,916		10,844,916	
International equity	15,969,847		15,969,847	
International small cap	3,283,981		3,283,981	
Emerging markets	7,890,447		7,890,447	
Alternative equity funds:				
Venture capital/private equity	16,485,805			\$ 16,485,805
Absolute return	4,656,354		4,656,354	
Multi-strategy hedge	29,379,229		12,917,095	16,462,134
Inflation protection equities and funds:				
Domestic real estate equity fund	1,554,385	1,554,385		
Diversified inflation hedge	4,872,665	4,872,665		
Alternative natural resources/realty	10,857,518			10,857,518
Fixed income funds:				
U.S. Government bonds	5,193,534		5,193,534	
Domestic bonds	2,685,890	2,685,890		
	\$133,024,543	\$ 22,368,943	\$ 66,850,143	\$ 43,805,457

The Zellerbach Family Foundation

Notes to Financial Statements

The table below presents the balances of assets measured at fair value on a recurring basis at December 31, 2012.

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Cash and cash equivalents	\$ 1,094,052	\$ 1,094,052		
Domestic equities and funds:				
Materials	1,009,709	1,009,709		
Industrials	3,217,447	3,217,447		
Consumer	1,843,251	1,843,251		
Energy	780,469	780,469		
Financials	627,695	627,695		
Information technology	984,897	984,897		
Healthcare	963,144	963,144		
Telecommunications	543,905	543,905		
Other	49,928	49,928		
Domestic equity fund	4,743,855		\$ 4,743,855	
Global equity funds:				
Global equity	8,087,268		8,087,268	
International equity	13,700,004		13,700,004	
International small cap	2,762,377		2,762,377	
Emerging markets	7,748,524		7,748,524	
Alternative equity funds:				
Venture capital/private equity	13,849,829			\$ 13,849,829
Absolute return	4,997,353		4,997,353	
Multi-strategy hedge	22,750,669		11,212,962	11,537,707
Inflation protection equities and funds:				
Domestic real estate equity fund	2,331,202	2,331,202		
Diversified inflation hedge	5,431,597		5,431,597	
Alternative natural resources/realty	10,246,279			10,246,279
Fixed income funds:				
U.S. Government bonds	5,336,728		5,336,728	
Domestic bonds	9,691,107	9,691,107		
	<u>\$122,791,289</u>	<u>\$ 23,136,806</u>	<u>\$ 64,020,668</u>	<u>\$ 35,633,815</u>

The Zellerbach Family Foundation

Notes to Financial Statements

A description of the valuation techniques and inputs applied to the Foundation's classes of investments which are not listed or quoted on a securities exchange or other regulated market measured at fair value is described in 2d.

The changes in investments classified as Level 3 for the years ended December 31, 2013 and 2012 are as follows:

December 31, 2013	Venture Capital / private equity	Multi- strategy hedge	Natural resources/ realty	Total
Balance, beginning of year	\$ 13,849,829	\$ 11,537,707	\$ 10,246,279	\$ 35,633,815
Purchases	2,090,347	3,000,000	978,450	6,068,797
Sales	(2,230,532)	(112,933)	(1,202,824)	(3,546,289)
Investment fees	(153,418)	(134,098)	(124,038)	(411,554)
Realized gains (loss)	-	(18,804)	-	(18,804)
Unrealized gain (loss)	2,929,579	2,190,263	959,650	6,079,492
Balance, end of year	\$ 16,485,805	\$ 16,462,134	\$ 10,857,518	\$ 43,805,457

December 31, 2012	Domestic equity	Venture Capital / private equity	Multi- strategy hedge	Natural resources/ realty	Total
Balance, beginning of year	\$ 5,325,837	\$ 13,128,579	\$ 5,300,259	\$ 8,720,428	\$ 32,475,103
Purchases		2,110,394		1,182,500	3,292,894
Sales		(2,489,913)	(41,106)	(745,821)	(3,276,840)
Transfers in/ (out)	(5,325,837)		5,258,221		(67,616)
Investment fees		(136,420)	(110,546)	(103,973)	(350,939)
Realized gains (loss)			(1,599)		(1,599)
Unrealized gain (loss)		1,237,189	1,132,478	1,193,145	3,562,812
Balance, end of year	\$ -	\$ 13,849,829	\$ 11,537,707	\$ 10,246,279	\$ 35,633,815

The Zellerbach Family Foundation

Notes to Financial Statements

Net Asset Value Disclosure:

The Foundation uses the Net Asset Value (NAV) as a practical expedient to determine the fair value of all the underlying investments which do not have readily determinable fair value and prepare their financial statements consistent with the measurement principles of an investment company or have the attributes of an investment company. The following table lists investments by major category as of December 31, 2013 and 2012:

Strategies	2013		2012		Redemption Frequency	Notice Period
	# of Funds	Valuation	# of Funds	Valuation		
Global and Domestic Equity Funds (a)	6	\$ 44,083,160	6	\$ 37,042,028	Monthly	6-60 days
Alternative Equity Funds:						
Venture Capital/Private Equity (b)	22	16,485,805	20	13,849,829		
Absolute Return (c)	1	4,656,354	1	4,997,353	Monthly	60 days
Multi-Strategy Hedge:						
Redeemable (d)	3	12,917,095	3	11,212,962	Monthly/ Quarterly	15-60 days
Non-Redeemable (e)	4	16,462,134	3	11,537,707		
Inflation Protection Funds:						
Diversified Inflation Hedge (f)			1	5,431,597		
Natural Resources/ Realty (g)	7	10,857,518	7	10,246,279		
Fixed Income Fund:						
U.S. Government Bonds (h)	1	5,193,534	1	5,336,728	Daily	2 days
Total	44	\$110,655,600	42	\$ 99,654,483		

- a) This strategy seeks to obtain long term returns through pooled funds invested in domestic, international, and global equities.

The Zellerbach Family Foundation

Notes to Financial Statements

- b) Venture capital and private equity funds invest in various companies, both domestic and international. All but one of these funds are fund of funds. The partnerships typically have a legal life span of 10-12 years with very limited redemption rights for the Limited Partners. Liquidity is expected in the form of distributions from the funds when the underlying assets are sold. It is estimated that the underlying assets will be redeemed over the next 12 years. Unfunded commitments were \$8,116,794 and \$7,207,141 for 2013 and 2012, respectively.
- c) The absolute return fund seeks exposure to currencies of emerging market countries by investing in money market instruments, including short-duration currency forwards and local currency debt. Currency forwards are the predominant investments and typically represent 60-70% of the fund.
- d) Redeemable multi-strategy hedge funds include one fund that engages primarily in event driven investments and in the securities of issuers that are experiencing financial distress, one fund that invests in futures in a range of asset classes, and one fund of funds that invests across six macro strategies.
- e) Non-redeemable multi-strategy hedge funds include one fund of funds that invests in long/short term offshore hedge funds, one fund of funds that invests in long/short and absolute return hedge funds, and one fund that invests in bank holding company stock and debt auctioned by the U.S. Department of Treasury under the Trouble Asset Relief Program (TARP). Also included is a small position in a pool of private investments, the proceeds from which will be distributed as they are sold.
- f) The diversified inflation hedge fund invests in a diversified mix of equities, commodities, inflation-linked bonds and other fixed income instruments that offer strong relative performance in rising inflation environments. The Foundation sold its interest in the investment during 2013.
- g) This strategy invests in both domestic and international natural resources and real estate funds. These funds (except for two) are fund of funds that cannot generally be redeemed and liquidity is expected in the form of distributions from the funds when the underlying assets are sold over the life of the partnerships, which is estimated to be over the next 12+ years. Two funds invest in royalty interests primarily in natural gas fields in the continental United States. These investments cannot be redeemed and distributions are received quarterly as royalty interest is generated. Unfunded commitments were \$3,809,800 and \$4,788,250 for 2013 and 2012, respectively.
- h) The fixed income fund invests in United States Government bonds.

Subsequent to year end, the Foundation invested \$1,000,000 in one new investment fund and executed investment commitments of \$1,000,000 with one new investment manager. Additionally, the Foundation paid capital calls of approximately \$1,500,000 on existing investment commitments.

The Zellerbach Family Foundation

Notes to Financial Statements

Note 5 - Federal Excise Taxes and Distribution Requirements:

In accordance with the applicable provisions of the Internal Revenue Code, the Foundation is a private foundation and qualifies as a tax-exempt organization. Private foundations are liable for an excise tax of 2% (1% if minimum payout requirements prescribed by the Internal Revenue Code are met) on net investment income, excluding unrealized gains, as defined. For the years ended December 31, 2013 and 2012, the excise tax rates were 2% and 1%, respectively. Deferred excise taxes arise primarily from unrealized tax basis gains on investments and are calculated at the effective rate expected to be paid by the Foundation.

The provision for current and deferred federal excise taxes for the years ended December 31, 2013 and 2012 was as follows:

	2013	2012
Current excise tax	\$ 134,000	\$ 102,000
Deferred excise tax	109,000	151,000
Total	\$ 243,000	\$ 253,000

The Foundation is subject to distribution requirements of the Internal Revenue Code. Accordingly, it must distribute within one year after the end of each fiscal year, 5% of the fair value of its investment assets, as defined. The investments includable for the 5% distribution requirement are based on average monthly balances and are exclusive of those assets deemed to be held for charitable activities or other program-related investments. In determining qualifying distributions, grant payments are considered on a cash basis and certain expenses are considered as qualifying distributions. The Foundation has complied with the distribution requirements through December 31, 2012 and 2013.

Note 6 - Grants Payable and Administrative Costs:

a. Grants Payable

Grants are expensed when the unconditional promise to give is approved by the Board of Directors. Total grants payable as of December 31, 2013 and 2012 were \$735,000 and \$615,000, respectively. Grants payable as of December 31, 2013 are expected to be paid in the following year.

b. Administrative Costs

The Foundation expended approximately \$900,000 and \$825,000 of support services toward grant administration in 2013 and 2012, respectively. The remaining expenses represent general and administrative support of approximately \$814,000 and \$743,000 in 2013 and 2012, respectively.

The Zellerbach Family Foundation

Notes to Financial Statements

Note 7 - Commitments:

a. Operating Leases

The Foundation leases office facilities under an operating lease agreement which expires in September 2014. The approximate future minimum rental payments required under the non-cancelable operating lease are \$180,000 for the year ending December 31, 2014.

Rental expense including common area charges was approximately \$249,000 and \$240,000 for the years ended December 31, 2013 and 2012, respectively.

b. Investments

As described in Note 4, the Foundation has capital commitments totaling approximately \$11,927,000 and \$11,995,000 as of December 31, 2013 and 2012, respectively.

Note 8 - Retirement Plans:

The Foundation maintains a defined contribution retirement plan. Under the plan, employees are allowed to contribute amounts up to statutory limits and, for employees working more than 1,000 hours per year and who have attained 21 years of age, the Foundation contributes 15% of employee compensation, as defined, to the plan. Vesting occurs after the second covered year of service. Employees are not required to make a contribution. The Foundation contributed \$123,693 and \$117,645 to the plan during 2013 and 2012, respectively.