

**The Houston Food Bank  
and Subsidiaries**

Consolidated Financial Statements  
and Independent Auditors' Report  
for the years ended June 30, 2012 and 2011

## Independent Auditors' Report

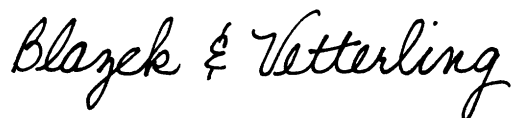
To the Board of Directors of  
The Houston Food Bank:

We have audited the accompanying consolidated statements of financial position of The Houston Food Bank and Subsidiaries as of June 30, 2012 and 2011 and the related consolidated statements of activities, of functional expenses, and of cash flows for the years then ended. These financial statements are the responsibility of the management of The Houston Food Bank and Subsidiaries. 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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform our audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of The Houston Food Bank and Subsidiaries as of June 30, 2012 and 2011 and the changes in their net assets and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 15, 2012, on our consideration of The Houston Food Bank and Subsidiaries' internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.



November 15, 2012

## The Houston Food Bank and Subsidiaries

Consolidated Statements of Financial Position as of June 30, 2012 and 2011

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	<u>2012</u>	<u>2011</u>
ASSETS		
Cash and cash equivalents ( <i>Note 2</i> )	\$ 2,784,098	\$ 6,693,054
Accounts receivables:		
Government grants and contracts	1,187,336	984,053
Agency	332,835	538,582
Food and other inventory	10,674,865	7,989,375
Prepaid expenses and other assets	592,491	454,314
Operating pledges receivable ( <i>Note 3</i> )	982,373	153,500
Debt issuance costs, net	365,665	380,357
Cash restricted by notes payable ( <i>Note 9</i> )	2,262,025	10,238,840
Pledges receivable restricted for property, net ( <i>Note 3</i> )	4,838,498	6,923,355
Investments ( <i>Notes 4 and 5</i> )	8,292,232	8,260,444
Note receivable ( <i>Note 6</i> )	36,856,479	36,856,479
Property and equipment, net ( <i>Note 7</i> )	<u>56,465,415</u>	<u>48,730,423</u>
<b>TOTAL ASSETS</b>	<b><u>\$ 125,634,312</u></b>	<b><u>\$ 128,202,776</u></b>
LIABILITIES AND NET ASSETS		
Liabilities:		
Accounts payable	\$ 1,757,116	\$ 999,172
Accrued expenses	611,708	609,696
Construction payable		1,696,581
Deferred revenue	10,585	37,047
Notes payable ( <i>Note 8</i> )	2,432,547	2,957,321
New market tax credits notes payable ( <i>Note 9</i> )	<u>48,964,971</u>	<u>48,964,971</u>
Total liabilities	<u>53,776,927</u>	<u>55,264,788</u>
Net assets ( <i>Note 13</i> ):		
Unrestricted ( <i>Note 10</i> )	69,133,717	25,266,853
Temporarily restricted ( <i>Note 11</i> )	1,282,278	46,229,745
Permanently restricted ( <i>Note 12</i> )	<u>1,441,390</u>	<u>1,441,390</u>
Total net assets	<u>71,857,385</u>	<u>72,937,988</u>
<b>TOTAL LIABILITIES AND NET ASSETS</b>	<b><u>\$ 125,634,312</u></b>	<b><u>\$ 128,202,776</u></b>

*See accompanying notes to consolidated financial statements.*

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## The Houston Food Bank and Subsidiaries

Consolidated Statement of Activities for the year ended June 30, 2012

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	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>PERMANENTLY RESTRICTED</u>	<u>TOTAL</u>
<b>REVENUE:</b>				
Donated food and household items <i>(Note 14)</i>	\$ 114,252,942			\$ 114,252,942
Contributions	7,798,129	\$ 1,907,060		9,705,189
Other in-kind contributions <i>(Note 14)</i>	843,030			843,030
Special events	1,512,774			1,512,774
Direct donor benefit costs	(35,413)			(35,413)
Government grants and contracts <i>(Note 15)</i>	4,549,418			4,549,418
Agency fees	2,107,202			2,107,202
Sales of purchased food	1,246,144			1,246,144
Food preparation fees	747,917			747,917
Investment return <i>(Note 4)</i>	496,463	(4,659)		491,804
Other income	<u>1,351,585</u>			<u>1,351,585</u>
Total revenue	134,870,191	1,902,401		136,772,592
Net assets released from restrictions:				
Capital expenditures	45,643,734	(45,643,734)		
Expenditures for program purposes	<u>1,206,134</u>	<u>(1,206,134)</u>		
Total	<u>181,720,059</u>	<u>(44,947,467)</u>		<u>136,772,592</u>
<b>EXPENSES:</b>				
Food distribution program	131,356,188			131,356,188
Management and general	4,233,579			4,233,579
Fundraising	<u>2,263,428</u>			<u>2,263,428</u>
Total expenses	<u>137,853,195</u>			<u>137,853,195</u>
CHANGES IN NET ASSETS	43,866,864	(44,947,467)		(1,080,603)
Net assets, beginning of year	<u>25,266,853</u>	<u>46,229,745</u>	<u>\$ 1,441,390</u>	<u>72,937,988</u>
Net assets, end of year	<u>\$ 69,133,717</u>	<u>\$ 1,282,278</u>	<u>\$ 1,441,390</u>	<u>\$ 71,857,385</u>

*See accompanying notes to consolidated financial statements.*

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## The Houston Food Bank and Subsidiaries

Consolidated Statement of Activities for the year ended June 30, 2011

	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>PERMANENTLY RESTRICTED</u>	<u>TOTAL</u>
REVENUE:				
Donated food and household items <i>(Note 14)</i>	\$ 112,192,034			\$ 112,192,034
Contributions	6,522,957	\$ 10,944,359		17,467,316
Other in-kind contributions <i>(Note 14)</i>	1,631,557			1,631,557
Special events	1,128,408			1,128,408
Direct donor benefit costs	(33,706)			(33,706)
Government grants and contracts <i>(Note 15)</i>	9,377,841			9,377,841
Agency fees	2,206,338			2,206,338
Sales of purchased food	794,438			794,438
Food preparation fees	771,343			771,343
Investment return <i>(Note 4)</i>	1,376,014	120,197		1,496,211
Gain on sale of building	1,278,901			1,278,901
Other income	<u>1,094,610</u>			<u>1,094,610</u>
Total revenue	138,340,735	11,064,556		149,405,291
Net assets released from restrictions:				
Expenditures for program purposes	602,210	(602,210)		
Donor redesignation	339,535	(102,097)	\$ (237,438)	
Equipment purchases	<u>229,040</u>	<u>(229,040)</u>		
Total	<u>139,511,520</u>	<u>10,131,209</u>	<u>(237,438)</u>	<u>149,405,291</u>
EXPENSES:				
Food distribution program	126,588,880			126,588,880
Management and general	3,101,425			3,101,425
Fundraising	<u>1,906,967</u>			<u>1,906,967</u>
Total expenses	<u>131,597,272</u>			<u>131,597,272</u>
CHANGES IN NET ASSETS	7,914,248	10,131,209	(237,438)	17,808,019
Net assets, beginning of year	<u>17,352,605</u>	<u>36,098,536</u>	<u>1,678,828</u>	<u>55,129,969</u>
Net assets, end of year	<u>\$ 25,266,853</u>	<u>\$ 46,229,745</u>	<u>\$ 1,441,390</u>	<u>\$ 72,937,988</u>

*See accompanying notes to consolidated financial statements.*

## The Houston Food Bank and Subsidiaries

### Consolidated Statement of Functional Expenses for the year ended June 30, 2012

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	FOOD DISTRIBUTION PROGRAM	MANAGEMENT AND GENERAL	FUNDRAISING	TOTAL
Salaries	\$ 4,704,353	\$ 1,523,734	\$ 923,733	\$ 7,151,820
Contract labor	872,172	268,029	57,273	1,197,474
Payroll taxes and benefits	<u>1,017,014</u>	<u>329,410</u>	<u>199,698</u>	<u>1,546,122</u>
Total salaries and related expenses	6,593,539	2,121,173	1,180,704	9,895,416
Donated food and supplies	112,634,726	6,601	17,209	112,658,536
Purchased food	2,993,311			2,993,311
Depreciation	1,797,598	135,698	74,073	2,007,369
Repairs and maintenance	1,146,505	60,330	48,497	1,255,332
Value-added processing expense	1,234,285			1,234,285
Trucking expense	1,213,291			1,213,291
Supplies and office expense	622,837	339,668	182,877	1,145,382
Utilities and telephone	855,876	222,931	41,252	1,120,059
Professional fees	38,153	647,170	250,548	935,871
Printing and boxes	189,685	93,070	350,115	632,870
Warehouse expense	583,265			583,265
Interest	458,108	34,582	18,877	511,567
Advertising	42,821	316,383	31,768	390,972
Volunteer meals	275,846			275,846
Travel	181,599	39,554	43,493	264,646
Insurance	124,673	63,731	469	188,873
Training and seminars	65,291	96,806	19,628	181,725
Equipment rental	131,192	27,411	3,918	162,521
Agency grants	131,004			131,004
Bad debt expense	30,932			30,932
Other	<u>11,651</u>	<u>28,471</u>	<u>          </u>	<u>40,122</u>
Total expenses	<u>\$ 131,356,188</u>	<u>\$ 4,233,579</u>	<u>\$ 2,263,428</u>	137,853,195
Direct donor benefit costs				<u>35,413</u>
Total				<u>\$ 137,888,608</u>

*See accompanying notes to consolidated financial statements.*

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## The Houston Food Bank and Subsidiaries

### Consolidated Statement of Functional Expenses for the year ended June 30, 2011

	FOOD DISTRIBUTION PROGRAM	MANAGEMENT AND GENERAL	FUNDRAISING	TOTAL
Salaries	\$ 3,987,114	\$ 1,324,119	\$ 847,214	\$ 6,158,447
Contract labor	1,222,112	110,871	32,853	1,365,836
Payroll taxes and benefits	<u>831,328</u>	<u>276,084</u>	<u>176,653</u>	<u>1,284,065</u>
Total salaries and related expenses	6,040,554	1,711,074	1,056,720	8,808,348
Donated food and supplies	109,996,521	16,801		110,013,322
Purchased food	2,494,232			2,494,232
Depreciation	1,031,546	168,829	23,731	1,224,106
Repairs and maintenance	723,353	16,166	8,439	747,958
Value-added processing expense	1,281,638			1,281,638
Trucking expense	1,344,561			1,344,561
Supplies and office expense	496,348	119,022	181,030	796,400
Utilities and telephone	608,427	134,945	1,849	745,221
Professional fees	175,638	562,176	209,153	946,967
Printing and boxes	371,615	116	345,169	716,900
Warehouse expense	536,568			536,568
Interest	404,381			404,381
Advertising	5,770	179,351	24,031	209,152
Volunteer meals	176,210			176,210
Travel	138,195	44,970	20,803	203,968
Insurance	124,405	52,962	14,171	191,538
Training and seminars	18,272	31,373	21,133	70,778
Equipment rental	405,557	5,822	575	411,954
Agency grants	76,036			76,036
Bad debt expense	119,096			119,096
Other	<u>19,957</u>	<u>57,818</u>	<u>163</u>	<u>77,938</u>
Total expenses	<u>\$ 126,588,880</u>	<u>\$ 3,101,425</u>	<u>\$ 1,906,967</u>	131,597,272
Direct donor benefit costs				<u>33,706</u>
Total				<u>\$ 131,630,978</u>

*See accompanying notes to consolidated financial statements.*

## The Houston Food Bank and Subsidiaries

Consolidated Statements of Cash Flows for the years ended June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Changes in net assets	\$ (1,080,603)	\$ 17,808,019
Adjustments to reconcile changes in net assets to net cash provided (used) by operating activities:		
Depreciation	2,007,369	1,224,106
Amortization of debt issuance costs	14,692	11,427
Gain on sale of property and equipment		(1,278,901)
Contributions restricted for capital campaign		(10,190,600)
Donated property		(209,447)
Realized and unrealized (gain) loss on investments	90,007	(910,779)
Changes in operating assets and liabilities:		
Accounts receivables	2,464	74,035
Food and other inventory	(2,685,490)	(3,220,109)
Prepaid expenses and other assets	(138,177)	(52,675)
Operating pledges receivable	(828,873)	170,564
Accounts payable and accrued expenses	759,956	242,892
Deferred revenue	<u>(26,462)</u>	<u>(52,878)</u>
Net cash provided (used) by operating activities	<u>(1,885,117)</u>	<u>3,615,654</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Proceeds from sale of investments	819,375	2,486,848
Purchases of investments	(815,866)	(4,295,925)
Net change in money market mutual funds and cash held for investment	(125,304)	(291,619)
Net change in cash restricted by notes payable	7,976,815	14,929,647
Proceeds from sale of property and equipment		1,977,315
Purchases of property and equipment	<u>(11,438,942)</u>	<u>(18,382,856)</u>
Net cash used by investing activities	<u>(3,583,922)</u>	<u>(3,576,590)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from contributions restricted for capital campaign	2,084,857	15,717,300
Payments of notes payable	<u>(524,774)</u>	<u>(9,163,310)</u>
Net cash provided by financing activities	<u>1,560,083</u>	<u>6,553,990</u>
<b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>	(3,908,956)	6,593,054
Cash and cash equivalents, beginning of year	<u>6,693,054</u>	<u>100,000</u>
Cash and cash equivalents, end of year	<u>\$ 2,784,098</u>	<u>\$ 6,693,054</u>
<i>Supplemental disclosure of cash flow information:</i>		
Interest paid	\$462,582	\$871,473

*See accompanying notes to consolidated financial statements.*



## The Houston Food Bank and Subsidiaries

Notes to Consolidated Financial Statements for the years ended June 30, 2012 and 2011

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### NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization – The Houston Food Bank is a Texas nonprofit organization founded in 1982 to help feed the hungry by seeking food donations and distributing them to local charitable agencies that care for the needy. The Houston Food Bank is a certified affiliate of Feeding America.

*Houston Food Bank Endowment* (the Endowment) was organized in 1990 as a Texas nonprofit organization to receive and maintain contributed funds and to support The Houston Food Bank. The Houston Food Bank is the sole member of the Endowment.

*The Mary Barden Keegan Food Fund, Inc.* (MBKFF) was organized in 2000 as a Texas nonprofit corporation to receive and maintain contributed funds to support End Hunger Network, Houston (End Hunger) or its successor organization. The Houston Food Bank is the sole member of MBKFF.

*HFB QALICB LLC* (QALICB) was organized in 2010 as a Texas limited liability company. The Houston Food Bank has a 99.9% membership interest and MBKFF has a 0.10% membership interest in QALICB. QALICB was organized to acquire and remodel a warehouse facility (the Portwall facility) for future use by The Houston Food Bank.

Basis of consolidation – These financial statements include the assets, liabilities, net assets, and activities of The Houston Food Bank, the Endowment, MBKFF, and QALICB (collectively The Food Bank). All balances and transactions between the consolidated entities have been eliminated.

Federal income tax status – The Houston Food Bank, the Endowment, and MBKFF are exempt from federal income tax under §501(c)(3) of the Internal Revenue Code. The Houston Food Bank is classified as a public charity under §170(b)(1)(A)(vi). The Endowment is classified as a Type III supporting organization under §509(a)(3). MBKFF is classified as a Type I supporting organization under §509(a)(3). The Houston Food Bank, the Endowment, and MBKFF files annual federal information returns and are subject to routine examinations of their returns; however, there are no examinations for any tax periods currently in progress. The Houston Food Bank, the Endowment, and MBKFF believe they are no longer subject to examinations of returns for tax years ending before June 30, 2009.

Cash equivalents include highly liquid financial instruments with original maturities of three months or less. Cash and cash equivalents held for long-term purposes are classified as investments.

Certificates of deposit – non-negotiable are reported at face value plus accrued interest.

Allowance for uncollectible receivables – An allowance for accounts receivable and pledges receivable is provided when management believes the balance may not be collected in full. The allowance is determined using a combination of historical loss experience and individual account by account analysis of accounts receivable balances and pledges receivable balances each period. It is possible that management's estimate regarding collectability will change in the near term resulting in a change in the carrying value of accounts receivable and pledges receivable.

Food and other inventory consist primarily of canned goods, produce, and durable household goods. Donated food inventory is valued at approximate average wholesale value of one pound of donated

product based on the national per pound price as provided by the most recent Feeding America Product Valuation Survey. Purchased food is valued at the cost of products purchased as determined by the first-in, first-out method. Inventory also includes items donated by a home improvement store for use by agencies. These items are valued at approximate fair market value. The Food Bank recognizes donated food, commodities, and other goods as inventory and as contributions in these consolidated financial statements.

Pledges receivable that are expected to be collected within one year are reported at net realizable value. Amounts expected to be collected in more than one year are discounted to estimate the present value of future cash flows.

Cash restricted by notes payable is held in interest-bearing bank accounts and exceeds the federally insured limit per depositor per institution.

Investments are reported at fair value. Investment return is reported in the statement of activities as an increase in unrestricted net assets unless the use of income is limited by donor-imposed restrictions. Investment return whose use is restricted by the donor is reported as an increase in temporarily restricted net assets.

Debt issuance costs represent costs incurred related to the issuance of the new market tax credits notes payable and are amortized over the term of the debt.

Note receivable is reported at its outstanding principal balance. The note receivable is considered to be fully collectible, and accordingly, no allowance for doubtful accounts has been provided. In making that determination, management evaluated the financial condition of the borrower, the estimated value of the underlying collateral, and current economic conditions. Interest on the note receivable is recognized over the term of the note receivable and is calculated using the simple-interest method on principal amounts outstanding.

Property and equipment are reported at cost, if purchased, or at the fair value at the date of gift, if donated. Depreciation is provided on a straight-line basis over estimated useful lives of 40 years for buildings and 5 years for furniture, equipment, and motor vehicles.

Net asset classification – Contributions, investment return, and the related net assets are classified based on the existence or absence of donor-imposed restrictions, as follows:

- *Unrestricted net assets* include those net assets whose use is not restricted by donor-imposed stipulations, even though their use may be limited in other respects, such as by contract or board designation.
- *Temporarily restricted net assets* include contributions and investment return restricted by the donor for specific purposes or time periods. When a purpose restriction is accomplished or a time restriction ends, temporarily restricted net assets are released to unrestricted net assets.
- *Permanently restricted net assets* include contributions that donors have restricted in perpetuity. Investment return on permanently restricted net assets is temporarily restricted until used in accordance with donor restrictions.

Contributions are recognized as revenue at fair value when an unconditional commitment is received from the donor. Contributions received with donor stipulations that limit their use are reported as restricted support. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be

maintained, The Food Bank reports expirations of donor restrictions when the donated or acquired long-lived assets are placed in service.

Non-cash contributions – Donated materials and use of facilities are recognized at fair value as contributions when an unconditional commitment is received from the donor. The related expense is recognized as the item is used. Contributions of services are recognized when services received (a) create or enhance nonfinancial assets or (b) require specialized skills, are provided by individuals possessing those skills, and would need to be purchased if not provided by donation. A substantial number of volunteers have contributed significant amounts of time in connection with the food distribution program for which no amount has been recorded in the financial statements because the donated services did not meet the criteria for recognition under generally accepted accounting principles.

Government grants and contracts are recognized when the related services are provided. Advances received for services not yet performed are reported in the statement of financial position as deferred revenue.

Agency fees represent fees paid by agencies for food handling charges and are recognized when shipments of food are made to the agencies.

Sales of purchased food are recognized as revenue when shipments of food are made to agencies.

Food preparation fees represent fees paid by agencies for reimbursement of costs of processing, cooking, and freezing meats for distribution. Fees are recognized when the meals are delivered.

Advertising costs are expensed as incurred.

Estimates – Management must make estimates and assumptions to prepare financial statements in accordance with generally accepted accounting principles. These estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, the amounts reported as revenue and expenses, and the allocation of expenses among various functions. Actual results could vary from the estimates that were used.

Adoption of accounting pronouncement – During 2012, The Food Bank implemented Accounting Standards Update No. 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements*, which resulted in additional disclosures. This statement requires an increased level of disaggregation in disclosing the level of fair value measurements. It also requires additional disclosures for inputs and valuation techniques used for Levels 2 and 3 fair value measurements.

## NOTE 2 – CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of the following:

	<u>2012</u>	<u>2011</u>
Demand deposits	\$ 2,684,098	\$ 6,593,054
Certificates of deposit – non-negotiable	<u>100,000</u>	<u>100,000</u>
Total cash and cash equivalents	<u>\$ 2,784,098</u>	<u>\$ 6,693,054</u>

### NOTE 3 – PLEDGES RECEIVABLE

The Food Bank launched the *Hunger Can't Wait Capital Campaign* in 2007 to grow The Food Bank. The goal of this campaign is to raise \$55 million to purchase the Portwall facility and build agency infrastructure in order to increase distribution. Through June 30, 2012, total contributions to the campaign were approximately \$47 million excluding any loan forgiveness as a result of exercising the put option as described in Note 9.

Pledges receivable consist of the following:

	<u>2012</u>	<u>2011</u>
Total pledges receivable	\$ 5,846,067	\$ 7,102,051
Discount to estimated present value at 1.76% to 1.79%	<u>(25,196)</u>	<u>(25,196)</u>
Total pledges receivable, net	5,820,871	7,076,855
Pledges receivable restricted for property, net	<u>(4,838,498)</u>	<u>(6,923,355)</u>
Operating pledges receivable	<u>\$ 982,373</u>	<u>\$ 153,500</u>

Pledges receivable at June 30, 2012 are expected to be collected as follows:

Receivable within one year	\$ 5,027,622
Receivable in one to five years	<u>818,445</u>
Total pledges receivable	<u>\$ 5,846,067</u>

At June 30, 2012, approximately 60% of pledges receivable were due from one donor.

### NOTE 4 – INVESTMENTS

Investments consist of the following:

	<u>2012</u>	<u>2011</u>
Debt securities	\$ 2,363,449	\$ 2,082,221
Equity securities	2,323,791	1,992,190
Domestic equity mutual funds	1,419,808	1,667,404
International equity mutual funds	1,170,148	1,359,083
Money market mutual funds	662,092	394,370
Other fixed-income securities	185,202	209,622
Certificates of deposit – negotiable	167,742	295,080
Cash		142,418
Domestic bond mutual funds	<u>                    </u>	<u>118,056</u>
Total investments	<u>\$ 8,292,232</u>	<u>\$ 8,260,444</u>

Investments are exposed to various risks such as interest rate, market and credit risks. Because of these risks, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the statement of financial position and statement of activities.

Investment return, including earnings on cash and cash equivalents, consists of the following:

	<u>2012</u>	<u>2011</u>
Interest and dividends	\$ 581,811	\$ 585,432
Realized and unrealized gain (loss) on investments	<u>(90,007)</u>	<u>910,779</u>
Total investment return	<u>\$ 491,804</u>	<u>\$ 1,496,211</u>

## NOTE 5 – FAIR VALUE MEASUREMENTS

Generally accepted accounting principles require that certain assets and liabilities be reported at fair value and establish a hierarchy that prioritizes inputs used to measure fair value. 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. The three levels of the fair value hierarchy are as follows:

- *Level 1* – Inputs are unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the reporting date.
- *Level 2* – Inputs are other than quoted prices included in Level 1, which are either directly observable or can be derived from or corroborated by observable market data at the reporting date.
- *Level 3* – Inputs are not observable and are based on the reporting entity’s assumptions about the inputs market participants would use in pricing the asset or liability.

Assets measured on a recurring basis at fair value at June 30, 2012 are as follows:

	<u>LEVEL 1</u>	<u>LEVEL 2</u>	<u>LEVEL 3</u>	<u>TOTAL</u>
Debt securities:				
Municipal bonds		\$ 1,265,846		\$ 1,265,846
Corporate bonds and notes		1,097,603		1,097,603
Equity securities:				
Consumer staples	\$ 599,043			599,043
Energy	397,754			397,754
Information technology	329,917			329,917
Healthcare	270,298			270,298
Preferred stock	215,292			215,292
Consumer discretionary	191,045			191,045
Financial	131,262			131,262
Capital goods	97,442			97,442
Materials	91,738			91,738
Domestic equity mutual funds:				
Large-cap	730,672			730,672
Mid-cap	689,136			689,136
International equity mutual funds:				
Large-cap	417,516			417,516
Small-cap	290,628			290,628
Strategic	280,987			280,987
Emerging markets	181,017			181,017
Money market mutual funds	662,092			662,092
Other fixed-income securities:				
Asset-backed securities		185,202		185,202
Certificates of deposit – negotiable		<u>167,742</u>		<u>167,742</u>
Total investments	<u>\$ 5,575,839</u>	<u>\$ 2,716,393</u>	<u>\$ 0</u>	<u>\$ 8,292,232</u>

Assets measured on a recurring basis at fair value at June 30, 2011 are as follows:

	<u>LEVEL 1</u>	<u>LEVEL 2</u>	<u>LEVEL 3</u>	<u>TOTAL</u>
Debt securities:				
Municipal bonds		\$ 903,892		\$ 903,892
Corporate bonds and notes		1,178,329		1,178,329
Equity securities:				
Consumer staples	\$ 511,710			511,710
Energy	373,333			373,333
Information technology	304,469			304,469
Healthcare	245,386			245,386
Consumer discretionary	171,373			171,373
Financial	161,659			161,659
Capital goods	121,517			121,517
Materials	102,743			102,743
Domestic equity mutual funds:				
Large-cap	787,600			787,600
Mid-cap	725,663			725,663
Index fund	154,141			154,141
International equity mutual funds:				
Large-cap	671,583			671,583
Mid-cap and small-cap	307,517			307,517
Strategic	305,912			305,912
Emerging markets	74,071			74,071
Money market mutual funds	394,370			394,370
Other fixed-income securities:				
Asset-backed securities		129,842		129,842
U. S. government agency obligations		7,974		7,974
Other		71,806		71,806
Certificates of deposit – negotiable		295,080		295,080
Domestic bond mutual funds	<u>118,056</u>			<u>118,056</u>
Total assets measured at fair value	<u>\$ 5,531,103</u>	<u>\$ 2,586,923</u>	<u>\$ 0</u>	8,118,026
Cash				<u>142,418</u>
Total investments				<u>\$ 8,260,444</u>

Valuation methods used for assets measured at fair value on a recurring basis are as follows:

- *Corporate bonds and notes, municipal bonds, certificates of deposit - negotiable, and other fixed-income securities* are valued using prices obtained from independent quotation bureaus that use computerized valuation formulas which may include market-corroborated inputs for credit risk factors, interest rate, yield curves, and broker quotes to calculate fair values.
- *Equity securities* are valued at the closing price reported on the active market on which the individual securities are traded.
- *Mutual funds* are valued at the net asset value of shares held at year end.

These valuation methods may produce a fair value that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while The Food Bank believes its valuation methods are appropriate, the use of different methods or assumptions could result in a different fair value measurement at the reporting date.

## NOTE 6 – NOTE RECEIVABLE

The Food Bank entered into an agreement on June 23, 2010 to lend \$36,856,479 to Chase NMTC Houston Food Bank Investment Fund, LLC (Chase NMTC Fund). The note is secured by Chase NMTC Fund's membership interest in NDC New Markets Investments LIX, LLC (NDC CDE), Business Loan Conduit No. 10, LLC (CRF CDE), and NDC New Markets Investment 46, LLC (LISC CDE), (collectively the CDE's) and other cash accounts held by a secured party. The interest rate on the note is fixed at 1%. Interest is payable quarterly beginning September 2010 until December 2017. All principal and unpaid interest is due and payable in June 2040. Interest earned in 2012 and 2011 was \$368,630 and \$368,565, respectively. At June 30, 2012 and 2011, \$122,893 and \$30,714 of interest income is accrued, respectively. The Food Bank may accelerate the maturity date of the note to December 2017 with 30 days notice to Chase NMTC Fund.

## NOTE 7 – PROPERTY AND EQUIPMENT

Property and equipment consists of the following:

	<u>2012</u>	<u>2011</u>
Land	\$ 5,210,382	\$ 5,210,382
Buildings	48,401,964	21,114,251
Furniture and equipment	3,933,784	3,376,014
Motor vehicles	2,709,720	4,186,512
Construction in progress	<u>                    </u>	<u>19,326,729</u>
Total property and equipment, at cost	60,255,850	53,213,888
Accumulated depreciation	<u>(3,790,435)</u>	<u>(4,483,465)</u>
Property and equipment, net	<u>\$ 56,465,415</u>	<u>\$ 48,730,423</u>

## NOTE 8 – NOTES PAYABLE

Notes payable consists of the following:

	<u>2012</u>	<u>2011</u>
Note payable to a bank, interest payable quarterly beginning in 2011 at the higher of prime rate or adjusted one month LIBOR plus 1.25% (3.74% at June 30, 2012), matures June 15, 2014, and collateralized by pledges receivable.	\$ 2,150,000	\$ 2,500,000
Note payable to a bank, interest payable monthly at a fixed rate of 6.75%, matures in December 2013 and collateralized by certain land and property.	<u>282,547</u>	<u>457,321</u>
Total notes payable	<u>\$ 2,432,547</u>	<u>\$ 2,957,321</u>

Notes payable, including the new market tax credits notes payable, at June 30, 2012 are due as follows:

2013	\$ 537,207
2014	1,895,340
2015	0
2016	0
Thereafter through 2040	<u>48,964,971</u>
Total notes payable	<u>\$ 51,397,518</u>

## NOTE 9 – NEW MARKET TAX CREDITS NOTES PAYABLE

QALICB executed a loan agreement on June 23, 2010, that provides for borrowings of \$12,125,000, \$26,500,000 and \$10,339,971 from NDC CDE, CRF CDE, and LISC CDE, respectively. The loans are to finance the purchase and renovations of the Portwall facility and are intended to be treated as a “qualified low-income community investment” for purposes of generating New Market Tax Credits under Section 45D of the Internal Revenue Code of 1986, as amended. The loans are secured by a property deed of trust, security agreement and fixture filing on this property and a guaranty by The Food Bank.

Pursuant to the issuance of the New Market Tax Credits Financing Commitment, QALICB is required to maintain certain funds at JPMorgan Chase Bank, N.A. At June 30, 2012 and 2011, \$2,262,025 and \$10,238,840 is held at JPMorgan Chase Bank, N.A. for this purpose, respectively.

Each loan accrues interest at 0.814%, payable quarterly beginning in September 2010 with the principal balance due in its entirety on the stated maturity dates. QALICB is not permitted to prepay any portion of the loans until the seventh anniversary of the loan. The balances outstanding on the notes payable, maturity dates and repayment terms are as follows:

	<u>AMOUNT</u>
Note payable to Business Loan Conduit No. 10, LLC matures on June 23, 2040, with principal payments commencing in September 2020.	\$ 20,146,863
Note payable to NDC New Markets Investment 46, LLC, matures on June 23, 2040, with principal payments commencing in September 2020.	8,878,237
Note payable to NDC New Markets Investments LIX, LLC, matures on June 21, 2040, with principal payments commencing in September 2020.	7,832,827
Note payable to Business Loan Conduit No. 10, LLC matures on June 23, 2040, with principal payments commencing in September 2030.	6,353,137
Note payable to NDC New Markets Investment 46, LLC, matures on June 23, 2040, with principal payments commencing in September 2030.	3,059,263
Note payable to NDC New Markets Investments LIX, LLC, matures on June 21, 2040, with principal payments commencing in September 2030.	2,507,144
Note payable to NDC New Markets Investment 46, LLC, matures on June 23, 2017, with principal payments commencing in September 2030.	<u>187,500</u>
Total new market tax credits notes payable	<u>\$ 48,964,971</u>

Interest expense of \$511,567 was recognized in 2012. Interest of \$400,189 was capitalized in 2011. At any time after the seventh anniversary and before the eighth anniversary of the note receivable, JPMorgan Chase Bank, N.A. can exercise its put option to sell its interest in the Chase NMTC Fund to The Food Bank for \$1,000. After exercising its option to purchase the interest in the Chase NMTC Fund, The Food Bank may cancel the new market tax credits notes payable.



#### **NOTE 10 – UNRESTRICTED NET ASSETS**

Unrestricted net assets consist of the following:

	<u>2012</u>	<u>2011</u>
Undesignated	\$ 65,092,992	\$ 20,617,036
Board-designated:		
Quasi-endowment for general operations	4,040,185	4,235,752
Mary Barden Keegan Food Fund	<u>                    </u>	<u>414,065</u>
Total unrestricted net assets	<u>\$ 69,133,177</u>	<u>\$ 25,266,853</u>

#### **NOTE 11 – TEMPORARILY RESTRICTED NET ASSETS**

Temporarily restricted net assets are available for the following purposes:

	<u>2012</u>	<u>2011</u>
Capital campaign		\$ 45,595,885
Equipment	\$ 140,185	113,734
Time restricted	844,874	150,000
Accumulated earnings on general endowment	41,523	89,343
Other	<u>255,696</u>	<u>280,783</u>
Total temporarily restricted net assets	<u>\$ 1,282,278</u>	<u>\$ 46,229,745</u>

#### **NOTE 12 – PERMANENTLY RESTRICTED NET ASSETS**

Permanently restricted net assets are invested to support the following:

	<u>2012</u>	<u>2011</u>
Houston Food Bank Endowment – general operations	\$ 946,390	\$ 946,390
End Hunger central building	<u>495,000</u>	<u>495,000</u>
Total permanently restricted net assets	<u>\$ 1,441,390</u>	<u>\$ 1,441,390</u>

During 2011, the original donors of the Mary Barden Keegan Food Fund redesignated the fund as an unrestricted board-designated endowment fund.

#### **NOTE 13 – ENDOWMENT FUNDS**

The Boards of Directors of MBKFF and the Endowment have interpreted the Texas Uniform Prudent Management of Institutional Funds Act (TUPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, The Food Bank classifies the original value of gifts donated to the permanent endowment as permanently restricted net assets. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by MBKFF and the Endowment in a manner consistent with the standard of prudence prescribed by TUPMIFA. In

accordance with TUPMIFA, MBKFF and the Endowment considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

- The duration and preservation of the funds
- The purposes of The Food Bank and the donor-restricted endowment funds
- General economic conditions
- The possible effect of inflation and deflation
- The expected total return from income and the appreciation of investments
- Other resources of The Food Bank
- The investment policies of MBKFF and the Endowment

### **Return Objectives and Risk Parameters**

MBKFF and the Endowment have adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to The Food Bank while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that MBKFF and the Endowment must hold in perpetuity or for a donor-specified period as well as board-designated funds. Under this policy, as approved by the Board of Directors, the endowment assets of the Endowment are invested in a manner that will seek to maintain a level of portfolio risk that is no more than 125% of the risk of the portfolio's tactical index. The Endowment expects its endowment funds, over time, to provide an average rate-of-return net of investment management expenses, of 5% plus the annual rate of inflation over any 10-year period.

### **Strategies Employed for Achieving Objectives**

To satisfy their long-term rate-of-return objectives, MBKFF and the Endowment rely on a total return strategy in which investment return is achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). MBKFF and the Endowment target a diversified asset allocation that places a greater emphasis on equity-based investments to achieve their long-term return objectives within prudent risk constraints.

### **Spending Policy**

The Endowment has a policy of not appropriating more than 5% of the endowment fund's average market value as of the end of the last three fiscal years prior to the year in which the distribution is planned. In establishing this policy, the Endowment considered the long-term expected return and the effects of inflation on its endowment. This is consistent with the Endowment's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment return. The Board of Directors of MBKFF determines annually the amount of appropriations to be made to The Food Bank.

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or TUPMIFA require MBKFF and the Endowment to retain as a fund of perpetual duration. Deficiencies of this nature are reported as unrestricted net assets.

Endowment net asset composition as of June 30, 2012 is as follows:

	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>PERMANENTLY RESTRICTED</u>	<u>TOTAL</u>
Board-designated endowment funds	\$ 4,040,185			\$ 4,040,185
Donor-restricted endowment funds	<u>                    </u>	<u>\$ 41,523</u>	<u>\$ 946,390</u>	<u>987,913</u>
Endowment net assets	<u>\$ 4,040,185</u>	<u>\$ 41,523</u>	<u>\$ 946,390</u>	<u>\$ 5,028,098</u>

Endowment net asset composition as of June 30, 2011 is as follows:

	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>PERMANENTLY RESTRICTED</u>	<u>TOTAL</u>
Board-designated endowment funds	\$ 4,235,752			\$ 4,235,752
Donor-restricted endowment funds	<u>                    </u>	<u>\$ 89,343</u>	<u>\$ 946,390</u>	<u>1,035,733</u>
Endowment net assets	<u>\$ 4,235,752</u>	<u>\$ 89,343</u>	<u>\$ 946,390</u>	<u>\$ 5,271,485</u>

Changes in net assets of the endowment funds are as follows:

	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>PERMANENTLY RESTRICTED</u>	<u>TOTAL</u>
Endowment net assets, June 30, 2010	<u>\$ 3,670,388</u>	<u>\$ 127,097</u>	<u>\$ 1,183,828</u>	<u>\$ 4,981,313</u>
Investment return:				
Interest and dividends	46,016	11,252		57,268
Net realized and unrealized gain	759,345	111,775		871,120
Investment management fees	<u>(11,576)</u>	<u>(2,830)</u>		<u>(14,406)</u>
Net investment return	<u>793,785</u>	<u>120,197</u>		<u>913,982</u>
Distribution	<u>(228,421)</u>	<u>(55,854)</u>		<u>(284,275)</u>
Donor redesignation		<u>(102,097)</u>	<u>(237,438)</u>	<u>(339,535)</u>
Endowment net assets, June 30, 2011	<u>4,235,752</u>	<u>89,343</u>	<u>946,390</u>	<u>5,271,485</u>
Investment return:				
Interest and dividends	72,624	17,758		90,382
Net realized and unrealized loss	(80,398)	(19,658)		(100,056)
Investment management fees	<u>(11,283)</u>	<u>(2,759)</u>		<u>(14,042)</u>
Net investment return	<u>(19,057)</u>	<u>(4,659)</u>		<u>(23,716)</u>
Distribution	<u>(176,510)</u>	<u>(43,161)</u>		<u>(219,671)</u>
Endowment net assets, June 30, 2012	<u>\$ 4,040,185</u>	<u>\$ 41,523</u>	<u>\$ 946,390</u>	<u>\$ 5,028,098</u>

#### **NOTE 14 – NON-CASH CONTRIBUTIONS**

Food donations – The majority of food distributed by The Food Bank is received by contributions from general donations and from the U.S. Department of Agriculture (USDA). The estimated value of these contributions is recognized in the financial statements as contribution revenue and inventory on program expenses if distributed during the year. The pounds collected are recorded by The Food Bank staff at the

time of receipt based on actual weight. The total value of contributed food for the years ended June 30, 2012 and 2011 is as follows:

	2012			2011		
	POUNDS	VALUE PER POUND	AMOUNT	POUNDS	VALUE PER POUND	AMOUNT
General donations	55,001,943	\$1.66	\$ 91,303,225	48,111,268	\$1.66	\$ 79,864,705
USDA	<u>13,825,131</u>	\$1.66	<u>22,949,717</u>	<u>19,474,295</u>	\$1.66	<u>32,327,329</u>
Total	<u>68,827,074</u>		<u>\$114,252,942</u>	<u>67,585,563</u>		<u>\$ 112,192,034</u>

Other donations – During 2012, The Food Bank received \$843,030 of other donated property, goods and services including \$777,715 of items from a home improvement store for use by agencies and \$20,000 of equipment and \$45,315 of miscellaneous goods and services. During 2011, The Food Bank received \$1,631,557 of other donated property, goods and services, including \$589,352 of donated warehouse space, \$534,460 of items from a home improvement store for use by agencies, \$408,749 of vehicles and equipment, \$38,840 of airline tickets, and \$59,796 of gift certificates, services, and supplies.

#### **NOTE 15 – GOVERNMENT GRANTS AND CONTRACTS**

The Food Bank is party to contracts with federal, state and local governmental agencies. Should these contracts not be renewed, a replacement for this source of support may not be forthcoming and related expenses would not be incurred. Sources of government grants and contracts are as follows:

	2012	2011
U.S. Department of Agriculture	\$ 4,151,496	\$ 9,263,823
Federal Department of Homeland Security	162,920	114,018
Texas Department of Agriculture	<u>235,002</u>	
Total federal and state grants and contracts	4,549,418	9,377,841
U.S. Department of Agriculture commodities	<u>22,949,717</u>	<u>32,327,329</u>
Total government grants and contracts	<u>\$ 27,499,135</u>	<u>\$ 41,705,170</u>

The grants from federal and state funding sources require fulfillment of certain conditions as set forth in the grant contracts and are subject to review and audit by the awarding agencies. Such reviews and audits could result in the discovery of unallowable activities and unallowable costs. Consequently, any of the funding sources may, at their discretion, request reimbursement for expenses or return of funds as a result of non-compliance by The Food Bank with the terms of the contracts. Management believes such disallowances, if any, would not be material to The Food Bank's financial position or changes in net assets.

#### **NOTE 16 – FREEZER LEASE**

The Food Bank entered into a 20-year lease agreement on February 15, 2010 to rent the freezer facility at the Portwall facility effective January 2011. The lease agreement includes two five-year renewal options. The following is a schedule of future rent income as of June 30, 2012:

2013	\$ 883,398
2014	883,398
2015	883,398
2016	883,398
2017	883,398
Thereafter through 2031	<u>12,687,423</u>
Total	<u>\$ 17,104,413</u>

In 2012, \$922,309 of rent income has been recognized in the financial statements related to this lease agreement. In 2011, \$471,697 of rent income was recognized in the financial statements related to this lease agreement.

**NOTE 17 – EMPLOYEE BENEFIT PLANS**

The Food Bank offers a defined contribution §401(k) benefit plan to qualified employees. The Food Bank matches 50% of an employee's contribution up to 6% of the employee's compensation. Contributions made by The Food Bank vest at the end of one year. The Food Bank's contributions to the plan totaled \$56,589 in 2012 and \$64,747 in 2011.

**NOTE 18 – SUBSEQUENT EVENTS**

Management has evaluated subsequent events through November 15, 2012, which is the date that the financial statements were available for issuance. As a result of this evaluation, no events were identified that are required to be disclosed or would have a material impact on reported net assets or changes in net assets.

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