

**The Houston Food Bank
and Subsidiaries**

Consolidated Financial Statements
and Independent Auditors' Report
for the years ended June 30, 2013 and 2012

The Houston Food Bank and Subsidiaries

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Blazek & Vetterling

CERTIFIED PUBLIC ACCOUNTANTS

Independent Auditors' Report

To the Board of Directors of
The Houston Food Bank:

Report on the Financial Statements

We have audited the accompanying financial statements of The Houston Food Bank and Subsidiaries, which comprise the consolidated statements of financial position as of June 30, 2013 and 2012 and the related consolidated statements of activities, of functional expenses, and of 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 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 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 consolidated financial position of The Houston Food Bank and Subsidiaries as of June 30, 2013 and 2012 and the changes in their net assets and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying supplementary information included on the consolidating statement of financial position and the consolidating statement of activities on pages 22 and 23 is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the financial statements as a whole.

Report Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated November 18, 2013 on our consideration of The Houston Food Bank and Subsidiaries' internal control over financial reporting and on 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering The Houston Food Bank and Subsidiaries' internal control over financial reporting and compliance.

Blazek & Vetterling

November 18, 2013

The Houston Food Bank and Subsidiaries

Consolidated Statements of Financial Position as of June 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
ASSETS		
Cash and cash equivalents <i>(Note 2)</i>	\$ 4,235,800	\$ 2,784,098
Accounts receivable:		
Government grants and contracts	683,598	1,187,336
Agency	440,890	332,835
Food and other inventory	15,131,216	10,674,865
Prepaid expenses and other assets	582,325	592,491
Pledges receivable <i>(Note 3)</i>	2,774,134	5,820,871
Debt issuance costs, net	356,959	365,665
Cash restricted by notes payable <i>(Notes 2 and 9)</i>	1,127,462	2,262,025
Investments <i>(Notes 4 and 5)</i>	8,485,738	8,292,232
Note receivable <i>(Note 6)</i>	36,856,479	36,856,479
Property and equipment, net <i>(Note 7)</i>	<u>56,572,745</u>	<u>56,465,415</u>
TOTAL ASSETS	<u>\$ 127,247,346</u>	<u>\$ 125,634,312</u>
LIABILITIES AND NET ASSETS		
Liabilities:		
Accounts payable	\$ 663,929	\$ 1,757,116
Accrued expenses	659,571	611,708
Deferred revenue	39,930	10,585
Notes payable <i>(Note 8)</i>	1,895,372	2,432,547
New market tax credits notes payable <i>(Note 9)</i>	<u>48,964,971</u>	<u>48,964,971</u>
Total liabilities	<u>52,223,773</u>	<u>53,776,927</u>
Net assets <i>(Note 13)</i> :		
Unrestricted <i>(Note 10)</i>	70,517,152	69,133,717
Temporarily restricted <i>(Note 11)</i>	3,065,031	1,282,278
Permanently restricted <i>(Note 12)</i>	<u>1,441,390</u>	<u>1,441,390</u>
Total net assets	<u>75,023,573</u>	<u>71,857,385</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 127,247,346</u>	<u>\$ 125,634,312</u>

See accompanying notes to consolidated financial statements.

The Houston Food Bank and Subsidiaries

Consolidated Statement of Activities for the year ended June 30, 2013

	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>PERMANENTLY RESTRICTED</u>	<u>TOTAL</u>
REVENUE:				
Donated food and household items <i>(Note 14)</i>	\$ 138,647,721			\$ 138,647,721
Contributions	7,999,640	\$ 3,558,385		11,558,025
Other in-kind contributions <i>(Note 14)</i>	1,087,576			1,087,576
Special events	1,827,174			1,827,174
Direct donor benefit costs	(41,592)			(41,592)
Government grants and contracts <i>(Note 15)</i>	5,187,415			5,187,415
Agency fees	2,303,218			2,303,218
Sales of purchased food	1,250,110			1,250,110
Building lease income	932,093			932,093
Food preparation fees	798,471			798,471
Investment return <i>(Note 4)</i>	1,046,351	141,467		1,187,818
Other income	<u>345,912</u>			<u>345,912</u>
Total revenue	161,384,089	3,699,852		165,083,941
Net assets released from restrictions:				
Capital expenditures	375,505	(375,505)		
Expenditures for program purposes	972,220	(972,220)		
Expiration of time restrictions	<u>569,374</u>	<u>(569,374)</u>		
Total	<u>163,301,188</u>	<u>1,782,753</u>		<u>165,083,941</u>
EXPENSES:				
Food distribution program	155,013,368			155,013,368
Management and general	4,268,172			4,268,172
Fundraising	<u>2,636,213</u>			<u>2,636,213</u>
Total expenses	<u>161,917,753</u>			<u>161,917,753</u>
CHANGES IN NET ASSETS	1,383,435	1,782,753		3,166,188
Net assets, beginning of year	<u>69,133,717</u>	<u>1,282,278</u>	\$ 1,441,390	<u>71,857,385</u>
Net assets, end of year	<u>\$ 70,517,152</u>	<u>\$ 3,065,031</u>	<u>\$ 1,441,390</u>	<u>\$ 75,023,573</u>

See accompanying notes to consolidated financial statements.

The Houston Food Bank and Subsidiaries

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

	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>PERMANENTLY RESTRICTED</u>	<u>TOTAL</u>
REVENUE:				
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
Building lease income	922,309			922,309
Food preparation fees	747,917			747,917
Investment return <i>(Note 4)</i>	496,463	(4,659)		491,804
Other income	429,276			429,276
	<u>134,870,191</u>	<u>1,902,401</u>		<u>136,772,592</u>
Net assets released from restrictions:				
Capital expenditures	45,643,734	(45,643,734)		
Expenditures for program purposes	1,206,134	(1,206,134)		
Total	<u>181,720,059</u>	<u>(44,947,467)</u>		<u>136,772,592</u>
EXPENSES:				
Food distribution program	131,356,188			131,356,188
Management and general	4,233,579			4,233,579
Fundraising	2,263,428			2,263,428
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.

The Houston Food Bank and Subsidiaries

Consolidated Statement of Functional Expenses for the year ended June 30, 2013

	FOOD DISTRIBUTION PROGRAM	MANAGEMENT AND GENERAL	FUNDRAISING	TOTAL
Salaries	\$ 5,693,490	\$ 1,738,302	\$ 1,248,622	\$ 8,680,414
Contract labor and intern stipends	728,361	256,985	32,522	1,017,868
Payroll taxes and benefits	<u>1,234,673</u>	<u>376,963</u>	<u>270,772</u>	<u>1,882,408</u>
Total salaries and related expenses	7,656,524	2,372,250	1,551,916	11,580,690
Distributed donated food and supplies	135,349,988	718	7,127	135,357,833
Purchased food	2,749,722			2,749,722
Depreciation	2,274,561	171,703	93,726	2,539,990
Value-added processing expense	1,360,677			1,360,677
Repairs and maintenance	1,130,984	36,964	61,744	1,229,692
Supplies and office expense	691,189	252,304	213,251	1,156,744
Trucking expense	1,207,727			1,207,727
Utilities and telephone	756,562	166,651	63,177	986,390
Professional fees	171,636	510,299	283,124	965,059
Printing and boxes	218,566	118,128	228,400	565,094
Warehouse expense	490,811			490,811
Interest	400,625	30,243	16,508	447,376
Advertising	9,626	281,319	41,826	332,771
Travel	190,800	48,197	45,078	284,075
Insurance	173,917	92,318	338	266,573
Training and seminars	24,573	86,784	27,453	138,810
Equipment rental	58,005	8,050	2,545	68,600
Bad debt expense		59,010		59,010
Agency grants	54,219			54,219
Other	<u>42,656</u>	<u>33,234</u>		<u>75,890</u>
Total expenses	<u>\$ 155,013,368</u>	<u>\$ 4,268,172</u>	<u>\$ 2,636,213</u>	161,917,753
Direct donor benefit costs				<u>41,592</u>
Total				<u>\$ 161,959,345</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

	FOOD DISTRIBUTION PROGRAM	MANAGEMENT AND GENERAL	FUNDRAISING	TOTAL
Salaries	\$ 4,704,353	\$ 1,523,734	\$ 923,733	\$ 7,151,820
Contract labor and intern stipends	1,148,018	268,029	57,273	1,473,320
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	6,869,385	2,121,173	1,180,704	10,171,262
Distributed 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
Value-added processing expense	1,234,285			1,234,285
Repairs and maintenance	1,146,505	60,330	48,497	1,255,332
Supplies and office expense	622,837	339,668	182,877	1,145,382
Trucking expense	1,213,291			1,213,291
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
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
Bad debt expense	30,932			30,932
Agency grants	131,004			131,004
Other	<u>11,651</u>	<u>28,471</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.

The Houston Food Bank and Subsidiaries

Consolidated Statements of Cash Flows for the years ended June 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Changes in net assets	\$ 3,166,188	\$ (1,080,603)
Adjustments to reconcile changes in net assets to net cash used by operating activities:		
Depreciation	2,539,990	2,007,369
Amortization of debt issuance costs	8,706	14,692
Realized and unrealized (gain) loss on investments	(623,037)	90,007
Changes in operating assets and liabilities:		
Accounts receivable	395,683	2,464
Food and other inventory	(4,456,351)	(2,685,490)
Prepaid expenses and other assets	10,166	(138,177)
Pledges receivable	(1,142,395)	(828,873)
Accounts payable and accrued expenses	(1,045,324)	759,956
Deferred revenue	29,345	(26,462)
Net cash used by operating activities	<u>(1,117,029)</u>	<u>(1,885,117)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sale of investments	811,445	819,375
Purchases of investments	(779,523)	(815,866)
Net change in money market mutual funds and cash held for investment	397,609	(125,304)
Net change in cash restricted by notes payable	1,134,563	7,976,815
Purchases of property and equipment	<u>(2,647,320)</u>	<u>(11,438,942)</u>
Net cash used by investing activities	<u>(1,083,226)</u>	<u>(3,583,922)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from contributions restricted for capital campaign	4,189,132	2,084,857
Payments of notes payable	<u>(537,175)</u>	<u>(524,774)</u>
Net cash provided by financing activities	<u>3,651,957</u>	<u>1,560,083</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	1,451,702	(3,908,956)
Cash and cash equivalents, beginning of year	<u>2,784,098</u>	<u>6,693,054</u>
Cash and cash equivalents, end of year	<u>\$ 4,235,800</u>	<u>\$ 2,784,098</u>
<i>Supplemental disclosure of cash flow information:</i>		
Interest paid	\$462,917	\$462,582

See accompanying notes to consolidated financial statements.

The Houston Food Bank and Subsidiaries

Notes to Consolidated Financial Statements for the years ended June 30, 2013 and 2012

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 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 I 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 file annual federal information returns that are subject to routine examination; however, there are no examinations for any tax periods currently in progress. QALICB files an annual U. S. Return of Partnership Income that is subject to routine examination; however, there are no examinations for any tax periods currently in progress. The Houston Food Bank, the Endowment, MBKFF and QALICB believe they are no longer subject to examinations of returns for tax years ended before June 30, 2010.

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. It is The Food Bank's policy to write-off receivables against the allowance when management determines the receivable will not be collected. 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 on the date of contribution. 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.

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.

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.

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 classified 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 classified 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 typically 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.

NOTE 2 – CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of the following:

	<u>2013</u>	<u>2012</u>
Demand deposits	\$ 5,263,262	\$ 4,946,123
Certificates of deposit – non-negotiable	<u>100,000</u>	<u>100,000</u>
Total cash and cash equivalents	5,363,262	5,046,123
Cash restricted by notes payable	<u>(1,127,462)</u>	<u>(2,262,025)</u>
Cash and cash equivalents	<u>\$ 4,235,800</u>	<u>\$ 2,784,098</u>

Demand deposits exceed the federally insured limit per depositor per institution.

NOTE 3 – PLEDGES RECEIVABLE

Pledges receivable consist of the following:

	<u>2013</u>	<u>2012</u>
Total pledges receivable	\$ 2,799,933	\$ 5,846,067
Discount to estimated present value at 1.76% to 1.79%	<u>(25,799)</u>	<u>(25,196)</u>
Total pledges receivable, net	<u>\$ 2,774,134</u>	<u>\$ 5,820,871</u>

Pledges receivable at June 30, 2013 are expected to be collected as follows:

Receivable in one year	\$ 1,170,997
Receivable in one to five years	<u>1,628,936</u>
Total pledges receivable	<u>\$ 2,799,933</u>

At June 30, 2013, approximately 29% of pledges receivable are due from one donor.

NOTE 4 – INVESTMENTS

Investments consist of the following:

	<u>2013</u>	<u>2012</u>
Equity securities	\$ 2,316,436	\$ 2,323,791
Debt securities	2,266,065	2,363,449
Domestic equity mutual funds	2,006,961	1,419,808
International equity mutual funds	1,347,700	1,170,148
Cash	207,329	
Asset-backed securities	173,330	185,202
Certificates of deposit – negotiable	110,763	167,742
Money market mutual funds	<u>57,154</u>	<u>662,092</u>
Total investments	<u>\$ 8,485,738</u>	<u>\$ 8,292,232</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>2013</u>	<u>2012</u>
Interest and dividends	\$ 564,781	\$ 581,811
Realized and unrealized gain (loss) on investments	<u>623,037</u>	<u>(90,007)</u>
Total investment return	<u>\$ 1,187,818</u>	<u>\$ 491,804</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 at fair value on a recurring basis at June 30, 2013 are as follows:

	<u>LEVEL 1</u>	<u>LEVEL 2</u>	<u>LEVEL 3</u>	<u>TOTAL</u>
Equity securities:				
Consumer staples	\$ 521,240			\$ 521,240
Energy	318,104			318,104
International	297,158			297,158
Information technology	256,769			256,769
Preferred stock	223,550			223,550
Consumer discretionary	212,250			212,250
Healthcare	176,855			176,855
Financial	138,941			138,941
Capital goods	106,518			106,518
Materials	65,051			65,051
Debt securities:				
Municipal bonds		\$ 1,240,312		1,240,312
Corporate bonds and notes		1,025,753		1,025,753
Domestic equity mutual funds:				
Mid-cap	1,413,809			1,413,809
Large-cap	593,152			593,152
International equity mutual funds:				
Large-cap	821,338			821,338
Strategic	348,442			348,442
Emerging markets	177,920			177,920
Asset-backed securities		173,330		173,330
Certificates of deposit – negotiable		110,763		110,763
Money market mutual funds	57,154			57,154
Total investments measured at fair value	<u>\$ 5,728,251</u>	<u>\$ 2,550,158</u>	<u>\$ 0</u>	8,278,409
Cash held as investments				<u>207,329</u>
Total investments				<u>\$ 8,485,738</u>

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

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

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

- *Equity securities* are valued at the closing price reported on the active market on which the individual securities are traded.
- *Municipal bonds, corporate bonds and notes, asset-backed securities, and certificates of deposit – negotiable* 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.
- *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.

Financial instruments – The carrying value of The Food Bank’s financial instruments including cash, pledges receivable, other short-term assets and liabilities, notes receivable, and debt approximates fair value at June 30, 2013 and 2012.

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 CDEs) 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 2013 and 2012 was \$368,215 and \$368,630, respectively. At June 30, 2013 and 2012, \$30,714 and \$122,893 of interest income is receivable, 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>2013</u>	<u>2012</u>
Land	\$ 5,210,382	\$ 5,210,382
Buildings	48,385,194	48,401,964
Furniture and equipment	5,483,840	3,933,784
Motor vehicles	<u>3,823,754</u>	<u>2,709,720</u>
Total property and equipment, at cost	62,903,170	60,255,850
Accumulated depreciation	<u>(6,330,425)</u>	<u>(3,790,435)</u>
Property and equipment, net	<u>\$ 56,572,745</u>	<u>\$ 56,465,415</u>

NOTE 8 – NOTES PAYABLE

Notes payable consists of the following:

	<u>2013</u>	<u>2012</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% (3.6925% at June 30, 2013), matures June 15, 2014, collateralized by pledges receivable	\$ 1,800,000	\$ 2,150,000
Note payable to a bank, interest payable monthly at a fixed rate of 6.75%, matures in December 2013, collateralized by certain land and property	<u>95,372</u>	<u>282,547</u>
Total notes payable	<u>\$ 1,895,372</u>	<u>\$ 2,432,547</u>

Notes payable, including the new market tax credits notes payable, at June 30, 2013 are due as follows:

2014	\$ 445,372
2015	1,450,000
2016	0
2017	0
Thereafter through 2040	<u>48,964,971</u>
Total notes payable	<u>\$ 50,860,343</u>

For the years ended June 30, 2013 and 2012, interest expense of \$447,376 and \$511,567, respectively, was recognized.

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, 2013 and 2012, \$1,127,462 and \$2,262,025 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>

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>2013</u>	<u>2012</u>
Undesignated	\$ 66,073,450	\$ 65,093,532
Board-designated – quasi-endowment for general operations	<u>4,443,702</u>	<u>4,040,185</u>
Total unrestricted net assets	<u>\$ 70,517,152</u>	<u>\$ 69,133,717</u>

NOTE 11 – TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets are available for the following purposes:

	<u>2013</u>	<u>2012</u>
Time restricted	\$ 1,358,009	\$ 844,874
Backpack Buddies	1,109,396	
Equipment and infrastructure	177,627	140,185
Accumulated earnings on general endowment	140,192	41,523
Other	<u>279,807</u>	<u>255,696</u>
Total temporarily restricted net assets	<u>\$ 3,065,031</u>	<u>\$ 1,282,278</u>

NOTE 12 – PERMANENTLY RESTRICTED NET ASSETS

Permanently restricted net assets are invested to support the following:

	<u>2013</u>	<u>2012</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>

NOTE 13 – ENDOWMENT FUNDS

The Boards of Directors of 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 the Endowment in a manner consistent with the standard of prudence prescribed by TUPMIFA. In accordance with TUPMIFA, 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 policy of the Endowment

Return Objectives and Risk Parameters

The Endowment has 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 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, the Endowment relies on a total return strategy in which investment return is achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Endowment targets 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.

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 requires 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, 2013 is as follows:

	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>PERMANENTLY RESTRICTED</u>	<u>TOTAL</u>
Board-designated endowment funds	\$ 4,443,702			\$ 4,443,702
Donor-restricted endowment funds	<u> </u>	\$ 140,192	\$ 946,390	<u>1,086,582</u>
Endowment net assets	<u>\$ 4,443,702</u>	<u>\$ 140,192</u>	<u>\$ 946,390</u>	<u>\$ 5,530,284</u>

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>	\$ 41,523	\$ 946,390	<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>

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, 2011	\$ 4,235,752	\$ 89,343	\$ 946,390	\$ 5,271,485
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>
Investment return:				
Interest and dividends	68,755	16,812		85,567
Net realized and unrealized gain	545,314	133,341		678,655
Investment management fees	<u>(35,522)</u>	<u>(8,686)</u>		<u>(44,208)</u>
Net investment return	<u>578,547</u>	<u>141,467</u>		<u>720,014</u>
Distribution	<u>(175,030)</u>	<u>(42,798)</u>		<u>(217,828)</u>
Endowment net assets, June 30, 2013	<u>\$ 4,443,702</u>	<u>\$ 140,192</u>	<u>\$ 946,390</u>	<u>\$ 5,530,284</u>

NOTE 14 – NON-CASH CONTRIBUTIONS

Food donations – The majority of food distributed by The Food Bank is received by contributions from general public 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 or 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, 2013 and 2012 is as follows:

	<u>2013</u>			<u>2012</u>		
	<u>POUNDS</u>	<u>VALUE PER POUND</u>	<u>AMOUNT</u>	<u>POUNDS</u>	<u>VALUE PER POUND</u>	<u>AMOUNT</u>
General donations	58,446,141	\$1.69	\$ 98,773,979	55,001,943	\$1.66	\$ 91,303,225
USDA	<u>23,593,931</u>	\$1.69	<u>39,873,742</u>	<u>13,825,131</u>	\$1.66	<u>22,949,717</u>
Total	<u>82,040,072</u>		<u>\$138,647,721</u>	<u>68,827,074</u>		<u>\$ 114,252,942</u>

Other donations – During 2013, The Food Bank received \$1,087,576 of other donated property, goods and services, including \$1,061,971 of items from a home improvement store for use by agencies and \$25,605 of miscellaneous goods and services. 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, \$20,000 of equipment and \$45,315 of miscellaneous goods and services.

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:

	<u>2013</u>	<u>2012</u>
U. S. Department of Agriculture	\$ 4,432,371	\$ 4,151,496
U. S. Department of Health and Human Services	474,473	
Federal Department of Homeland Security	186,613	162,920
Texas Department of Agriculture		235,002
City of Houston	<u>93,959</u>	<u> </u>
Total federal, state, and city grants and contracts	5,187,416	4,549,418
U. S. Department of Agriculture commodities	<u>39,873,742</u>	<u>22,949,717</u>
Total government grants and contracts	<u>\$ 45,061,158</u>	<u>\$ 27,499,135</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 April 2010. The lease agreement includes two five-year renewal options. The following is a schedule of future rent income as of June 30, 2013:

2014	\$ 883,398
2015	883,398
2016	883,398
2017	883,398
2018	883,398
Thereafter through 2030	<u>11,067,860</u>
Total	<u>\$ 15,484,850</u>

Rental income of \$932,093 and \$922,309 has been recognized in the financial statements related to this lease agreement for 2013 and 2012, respectively.

NOTE 17 – EMPLOYEE BENEFIT PLAN

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 \$90,937 in 2013 and \$56,589 in 2012.

NOTE 18 – SUBSEQUENT EVENTS

Management has evaluated subsequent events through November 18, 2013, 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.

The Houston Food Bank and Subsidiaries

Consolidating Statement of Financial Position as of June 30, 2013

	HOUSTON FOOD BANK	QALICB	ENDOWMENT	ELIMINATIONS	TOTAL
ASSETS					
Cash and cash equivalents	\$ 4,235,800				\$ 4,235,800
Accounts receivable:					
Government grants and contracts	683,598				683,598
Agency	424,732	\$ 16,158			440,890
Intercompany	3,084,741	780,265	\$ 482,697	\$ (4,347,703)	
Food and other inventory	15,131,216				15,131,216
Prepaid expenses and other assets	510,321	72,004			582,325
Pledges receivable	2,774,134				2,774,134
Debt issuance costs, net		356,959			356,959
Cash restricted by notes payable	201,433	926,029			1,127,462
Investments	2,502,666		5,983,072		8,485,738
Note receivable	36,856,479				36,856,479
Property and equipment, net	8,965,137	47,607,608			56,572,745
TOTAL ASSETS	\$ 75,370,257	\$49,759,023	\$ 6,465,769	\$ (4,347,703)	\$ 127,247,346
LIABILITIES AND NET ASSETS					
Liabilities:					
Accounts payable	\$ 654,538	\$ 9,391			\$ 663,929
Accrued expenses	576,880	82,691			659,571
Intercompany payables	780,265	3,567,438		\$ (4,347,703)	
Deferred revenue	39,930				39,930
Notes payable	1,895,372				1,895,372
New market tax credits notes payable		48,964,971			48,964,971
Total liabilities	3,946,985	52,624,491		(4,347,703)	52,223,773
Net assets:					
Unrestricted	68,003,433	(2,865,468)	\$ 5,379,187		70,517,152
Temporarily restricted	2,924,839		140,192		3,065,031
Permanently restricted	495,000		946,390		1,441,390
Total net assets	71,423,272	(2,865,468)	6,465,769		75,023,573
TOTAL LIABILITIES AND NET ASSETS	\$ 75,370,257	\$49,759,023	\$ 6,465,769	\$ (4,347,703)	\$ 127,247,346

The Houston Food Bank and Subsidiaries

Consolidating Statement of Activities for the year ended June 30, 2013

	HOUSTON FOOD BANK	QALICB	ENDOWMENT	ELIMINATIONS	TOTAL
REVENUE:					
Donated food and household items	\$138,647,721				\$ 138,647,721
Contributions	11,558,025				11,558,025
Other in-kind contributions	1,087,576				1,087,576
Special events	1,827,174				1,827,174
Direct donor benefit costs	(41,592)				(41,592)
Government grants and contracts	5,187,415				5,187,415
Agency fees	2,303,218				2,303,218
Sales of purchased food	1,250,110				1,250,110
Building lease income	10,617	\$ 1,289,691		\$ (368,215)	932,093
Food preparation fees	798,471				798,471
Investment return	421,453	1,460	\$ 764,905		1,187,818
Other income	345,912				345,912
Total revenue	163,396,100	1,291,151	764,905	(368,215)	165,083,941
EXPENSES:					
Food distribution program	153,992,834	1,388,749		(368,215)	155,013,368
Management and general	3,766,795	459,443	41,934		4,268,172
Fundraising	2,581,441	54,772			2,636,213
Total expenses	160,341,070	1,902,964	41,934	(368,215)	161,917,753
CHANGES IN NET ASSETS	3,055,030	(611,813)	722,971	0	3,166,188
Net assets, beginning of year	68,368,242	(2,253,655)	5,742,798	0	71,857,385
Net assets, end of year	\$ 71,423,272	\$ (2,865,468)	\$ 6,465,769	\$ 0	\$ 75,023,573