

The Houston Food Bank and Subsidiaries

Independent Auditor's Reports and
Consolidated Financial Statements

June 30, 2019 and 2018



The Houston Food Bank and Subsidiaries

June 30, 2019 and 2018

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Independent Auditor's Report

Board of Directors
The Houston Food Bank and Subsidiaries
Houston, Texas

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of The Houston Food Bank and Subsidiaries, which comprise the consolidated statements of financial position as of June 30, 2019 and 2018, and the related consolidated statements of activities, functional expenses and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated 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 consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated 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 the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated 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 consolidated 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, 2019 and 2018, 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.

Emphasis of Matter

As described in Note 1 of the consolidated financial statements, in 2019, The Houston Food Bank and Subsidiaries adopted Accounting Standards Update 2016-14, *Not-for-Profit Entities* (Topic 958): *Presentation of Financial Statements of Not-for-Profit Entities*. Our opinion is not modified with respect to this matter.

Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying supplementary information, including the schedule of expenditures of federal and state awards for the year ended June 30, 2019, as required by Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* and in the schedule of expenditures of state awards for the year ended June 30, 2019, as required by the State of Texas *Uniform Grant Management Standards* is presented for purposes of additional analysis and is not a required part of the consolidated 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 consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated 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 consolidated financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we also have issued our report dated October 31, 2019, 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 solely 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 effectiveness of The Houston Food Bank and Subsidiaries' 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.

BKD, LLP

Houston, Texas
October 31, 2019

The Houston Food Bank and Subsidiaries
Consolidated Statements of Financial Position
June 30, 2019 and 2018

	2019	2018
Assets		
Cash	\$ 4,685,157	\$ 18,828,975
Accounts receivable:		
Government grants and contracts	3,876,275	1,991,521
Agency	402,123	15,634
Food and other supplies	20,276,114	15,998,741
Prepaid expenses	1,073,538	1,221,913
Operating pledges receivable, net	988,179	967,017
Operating investments	2,757,131	2,618,219
Notes receivable	4,763,187	4,763,187
Pledges receivable for capital campaign, net	685,695	1,638,706
Investments internally designated for endowment and quasi-endowment funds	7,244,786	6,741,993
Property and equipment, net	<u>62,859,516</u>	<u>63,987,109</u>
Total assets	<u>\$ 109,611,701</u>	<u>\$ 118,773,015</u>
Liabilities and Net Assets		
Liabilities		
Accounts payable	\$ 1,820,482	\$ 3,276,111
Accrued expenses	1,052,903	966,803
Capital lease payable	2,832,623	3,220,171
New market tax credits notes payable, net	<u>6,227,838</u>	<u>6,217,941</u>
Total liabilities	<u>11,933,846</u>	<u>13,681,026</u>
Net Assets		
Without donor restrictions	92,629,746	101,308,335
With donor restrictions	<u>5,048,109</u>	<u>3,783,654</u>
Total net assets	<u>97,677,855</u>	<u>105,091,989</u>
Total liabilities and net assets	<u>\$ 109,611,701</u>	<u>\$ 118,773,015</u>

The Houston Food Bank and Subsidiaries
Consolidated Statement of Activities
Year Ended June 30, 2019

	2019		
	Without Donor Restrictions	With Donor Restrictions	Total
Revenues, Gains and Other Support			
Donated food	\$ 169,620,944	\$ -	\$ 169,620,944
Contributions	14,029,945	5,627,644	19,657,589
Other noncash contributions	444,218		444,218
Special events	499,982	380,260	880,242
Direct donor benefit costs	(197,954)	-	(197,954)
Government grants and contracts	13,821,013	-	13,821,013
Agency fees	1,992,807	-	1,992,807
Other grants and contracts	1,079,355	-	1,079,355
Investment return	780,729	98,267	878,996
Freezer lease income	890,665	-	890,665
Sales of purchased food	166,679	-	166,679
Gain on sales of property and equipment	51,522	-	51,522
Other income	539,366	-	539,366
	203,719,271	6,106,171	209,825,442
Net Assets Released From Restrictions			
Expenditures for program purposes	3,883,939	(3,883,939)	-
Expiration of time restrictions	957,777	(957,777)	-
Total net assets released from restrictions	4,841,716	(4,841,716)	0
Total revenues, gains and other support	208,560,987	1,264,455	209,825,442
Expenses			
Program services	207,825,885	-	207,825,885
Management and general	5,446,285	-	5,446,285
Fund-raising	3,967,406	-	3,967,406
Total expenses	217,239,576	0	217,239,576
Increase (Decrease) in Net Assets	(8,678,589)	1,264,455	(7,414,134)
Net Assets, Beginning of Year	101,308,335	3,783,654	105,091,989
Net Assets, End of Year	\$ 92,629,746	\$ 5,048,109	\$ 97,677,855

The Houston Food Bank and Subsidiaries
Consolidated Statement of Activities
Year Ended June 30, 2018

	2018		
	Without Donor Restrictions	With Donor Restrictions	Total
Revenues, Gains and Other Support			
Donated food	\$ 250,555,289	\$ -	\$ 250,555,289
Contributions	28,076,408	48,019,990	76,096,398
Other noncash contributions	1,695,081	-	1,695,081
Special events	348,753	313,918	662,671
Direct donor benefit costs	(128,607)	-	(128,607)
Government grants and contracts	8,865,932	-	8,865,932
Agency fees	387,116	-	387,116
Other grants and contracts	690,080	-	690,080
Investment return	683,355	118,713	802,068
Freezer lease income	1,544,001	-	1,544,001
Sales of purchased food	63,752	-	63,752
Gain on sales of property and equipment	54,672	-	54,672
Other income	614,176	-	614,176
	<hr/> <u>293,450,008</u>	<hr/> <u>48,452,621</u>	<hr/> <u>341,902,629</u>
Net Assets Released From Restrictions			
Capital expenditures	10,416,536	(10,416,536)	-
Expenditures for program purposes	38,683,011	(38,683,011)	-
Expiration of time restrictions	<hr/> <u>275,919</u>	<hr/> <u>(275,919)</u>	<hr/> <u>-</u>
Total net assets released from restrictions	<hr/> <u>49,375,466</u>	<hr/> <u>(49,375,466)</u>	<hr/> <u>0</u>
Total revenues, gains and other support	<hr/> <u>342,825,474</u>	<hr/> <u>(922,845)</u>	<hr/> <u>341,902,629</u>
Expenses			
Program services	297,323,497	-	297,323,497
Management and general	7,674,306	-	7,674,306
Fund-raising	<hr/> <u>4,486,171</u>	<hr/> <u>-</u>	<hr/> <u>4,486,171</u>
Total expenses	<hr/> <u>309,483,974</u>	<hr/> <u>0</u>	<hr/> <u>309,483,974</u>
Increase (Decrease) in Net Assets	<hr/> <u>33,341,500</u>	<hr/> <u>(922,845)</u>	<hr/> <u>32,418,655</u>
Net Assets, Beginning of Year	<hr/> <u>67,966,835</u>	<hr/> <u>4,706,499</u>	<hr/> <u>72,673,334</u>
Net Assets, End of Year	<hr/> <u>\$ 101,308,335</u>	<hr/> <u>\$ 3,783,654</u>	<hr/> <u>\$ 105,091,989</u>

The Houston Food Bank and Subsidiaries

Consolidated Statement of Functional Expenses

Year Ended June 30, 2019

	Program Services					Support Services				Total
	Food Distribution	Child Hunger Initiatives*	Client Assistance Program*	Other Program Services*	Total Program Services	Management and General	Fund-raising	Total Support Services		
Salaries	\$ 10,251,011	\$ 1,119,593	\$ 1,276,516	\$ 805,567	\$ 13,452,687	\$ 2,227,947	\$ 1,271,758	\$ 3,499,705	\$ 16,952,392	
Contract labor and intern stipends	645,907	36,631	10,771		693,309	23,956	1,596	25,552	718,861	
Payroll taxes and benefits	2,412,760	267,110	280,826	169,031	3,129,727	485,002	263,247	748,249	3,877,976	
Total salaries and related expenses	13,309,678	1,423,334	1,568,113	974,598	17,275,723	2,736,905	1,536,601	4,273,506	21,549,229	
Distributed donated food and supplies	165,726,264	961,867	-	1,496	166,689,627	-	298,500	298,500	166,988,127	
Purchased food	1,205,866	3,236,800	-	315,998	4,758,664	-	-	-	4,758,664	
Depreciation	4,868,182	212,741	38,307	215,965	5,335,195	131,043	71,496	202,539	5,537,734	
Supplies and office expense	576,241	419,572	32,953	224,397	1,253,163	562,717	694,399	1,257,116	2,510,279	
Professional fees and contract services	1,555,936	78,841	18,559	230,341	1,883,677	1,114,629	403,669	1,518,298	3,401,975	
Trucking expenses	1,448,881	5,566	360	26,345	1,481,152	-	-	-	1,481,152	
Value added processing expenses	1,473,680	-	1,879	-	1,475,559	-	-	-	1,475,559	
Printing and boxes	360,360	-	-	3,343	363,703	55,479	876,518	931,997	1,295,700	
Utilities and telephone	985,252	21,375	3,697	19,330	1,029,654	107,224	7,705	114,929	1,144,583	
Equipment rental	906,155	64,972	-	12,840	983,967	69,740	1,652	71,392	1,055,359	
Warehouse expense	1,178,968	1,815	4,313	1,176	1,186,272	330	-	330	1,186,602	
Interest	211,200	-	-	-	211,200	277,875	-	277,875	489,075	
Insurance	754,907	54,562	-	78,186	887,655	43,698	-	43,698	931,353	
Agency grants	180,602	-	-	-	180,602	-	-	-	180,602	
Travel	197,670	45,433	98,140	27,199	368,442	32,495	18,096	50,591	419,033	
Advertising	4,247	5,481	-	5,842	15,570	182,279	11,640	193,919	209,489	
Training and seminars	32,017	49	49	1,260	33,375	91,759	8,640	100,399	133,774	
Repairs and maintenance	2,379,678	3,400	-	5,283	2,388,361	25,885	38,311	64,196	2,452,557	
Other	2,352	45	-	21,927	24,324	14,227	179	14,406	38,730	
Total expenses	\$ 197,358,136	\$ 6,535,853	\$ 1,766,370	\$ 2,165,526	\$ 207,825,885	\$ 5,446,285	\$ 3,967,406	\$ 9,413,691	\$ 217,239,576	

*See program descriptions in Note 1 of the Notes to Consolidated Financial Statements.

The Houston Food Bank and Subsidiaries
Consolidated Statement of Functional Expenses
Year Ended June 30, 2018

	Program Services					Support Services				Total
	Food Distribution	Child Hunger Initiatives*	Client Assistance Program*	Other Program Services*	Total Program Services	Management and General	Fund-raising	Total Support Services		
Salaries	\$ 10,043,305	\$ 1,052,313	\$ 660,097	\$ 727,959	\$ 12,483,674	\$ 2,303,589	\$ 1,246,972	\$ 3,550,561	\$ 16,034,235	
Contract labor and intern stipends	2,349,004	65,021	-	-	2,414,025	110,893	100,348	211,241	2,625,266	
Payroll taxes and benefits	2,319,996	229,404	142,791	206,001	2,898,192	489,224	269,991	759,215	3,657,407	
Total salaries and related expenses	14,712,305	1,346,738	802,888	933,960	17,795,891	2,903,706	1,617,311	4,521,017	22,316,908	
Distributed donated food and supplies	244,588,225	394,076	-	6,632	244,988,933	-	47,467	47,467	245,036,400	
Purchased food	7,385,739	4,835,588	266	355,675	12,577,268	-	-	-	12,577,268	
Depreciation	2,666,057	201,349	25,197	234,158	3,126,761	642,618	76,766	719,384	3,846,145	
Supplies and office expense	792,448	470,868	83,386	566,235	1,912,937	985,024	673,925	1,658,949	3,571,886	
Professional fees and contract services	414,686	2,972	685	149,904	568,247	1,800,367	1,135,909	2,936,276	3,504,523	
Trucking expenses	5,290,742	26,055	1,100	41,317	5,359,214	-	-	-	5,359,214	
Value added processing expenses	1,243,403	-	-	-	1,243,403	-	-	-	1,243,403	
Printing and boxes	467,546	-	14,865	3,033	485,444	45,928	814,380	860,308	1,345,752	
Utilities and telephone	750,456	11,858	5,212	7,813	775,339	141,080	7,011	148,091	923,430	
Equipment rental	1,713,304	38,999	-	11,116	1,763,419	136,330	6,404	142,734	1,906,153	
Warehouse expense	1,420,036	8,834	42	824	1,429,736	5,431	-	5,431	1,435,167	
Interest	56,945	-	-	-	56,945	206,314	-	206,314	263,259	
Insurance	422,559	31,098	-	40,709	494,366	66,360	-	66,360	560,726	
Agency grants	2,211,949	-	-	51,944	2,263,893	142,348	-	142,348	2,406,241	
Travel	281,449	49,606	67,571	34,559	433,185	45,305	47,297	92,602	525,787	
Advertising	3,986	-	73	4,185	8,244	207,297	43,148	250,445	258,689	
Training and seminars	38,628	545	1,333	25,019	65,525	58,665	10,019	68,684	134,209	
Repairs and maintenance	1,909,612	2,801	-	2,111	1,914,524	263,011	605	263,616	2,178,140	
Other	35,356	53	-	24,814	60,223	24,522	5,929	30,451	90,674	
Total expenses	\$ 286,405,431	\$ 7,421,440	\$ 1,002,618	\$ 2,494,008	\$ 297,323,497	\$ 7,674,306	\$ 4,486,171	\$ 12,160,477	\$ 309,483,974	

*See program descriptions in Note 1 of the Notes to Consolidated Financial Statements.

The Houston Food Bank and Subsidiaries
Consolidated Statements of Cash Flows
Years Ended June 30, 2019 and 2018

	2019	2018
Operating Activities		
Increase in net assets	\$ (7,414,134)	\$ 32,418,655
Items not requiring (providing) operating activities cash flows:		
Depreciation of fixed assets	5,537,734	3,846,145
Amortization of debt issuance costs	9,897	9,897
Changes in food and other supplies inventory	(4,277,373)	(6,687,866)
Contributions received restricted for endowment	-	(15,000)
Contribution of long-lived assets	-	(542,116)
Realized and unrealized gain on investments	(446,757)	(439,464)
Changes in:		
Accounts receivable	(2,271,243)	603,381
Pledges receivable	53,150	236,137
Prepaid expense	148,375	(792,122)
Accounts payable and accrued expenses	(1,369,529)	1,192,945
Deferred revenue	-	(183,000)
Net cash provided by (used in) operating activities	<u>(10,029,880)</u>	<u>29,647,592</u>
Investing Activities		
Purchase of property and equipment	(4,461,663)	(9,973,180)
Proceeds from disposition of investments	1,403,284	1,020,953
Purchase of investments	(1,598,232)	(1,218,207)
Proceeds from disposition of property and equipment	<u>51,522</u>	<u>54,672</u>
Net cash used in investing activities	<u>(4,605,089)</u>	<u>(10,115,762)</u>
Financing Activities		
Proceeds from contributions restricted for capital campaign	878,699	763,056
Principal payments on new market tax credits notes payable and note payable to bank	-	(2,763,515)
Principal payments on capital lease	<u>(387,548)</u>	<u>(92,767)</u>
Net cash provided by (used in) financing activities	<u>491,151</u>	<u>(2,093,226)</u>
Net Increase (Decrease) in Cash	<u>(14,143,818)</u>	<u>17,438,604</u>
Cash, Beginning of Year	<u>18,828,975</u>	<u>1,390,371</u>
Cash, End of Year	<u><u>\$ 4,685,157</u></u>	<u><u>\$ 18,828,975</u></u>
Supplemental Cash Flows Information		
Capital lease liability incurred for purchase of property	\$ -	\$ 3,312,938
Interest paid	489,075	263,259

The Houston Food Bank and Subsidiaries

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

Note 1: Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

The Houston Food Bank and Subsidiaries (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 organization 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 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 99.90 percent membership interest and MBKFF has a 0.10 percent membership interest in QALICB. QALICB was organized to acquire and remodel a warehouse facility (the Portwall facility) for use by The Houston Food Bank.

In August 2017, Hurricane Harvey caused widespread flooding and property damage in Texas, including the Houston area, and had a significant impact on the Houston Food Bank's operations. The Houston Food Bank distributed over 125 million pounds of food in 2019 as compared to 146 million pounds in 2018. Contributions decreased significantly in fiscal year 2019 due to contributions designated for disaster relief and operations in fiscal year 2018. The value of food donations in 2019, including assistance from the Federal Emergency Management Agency (FEMA), was \$81 million lower than fiscal year 2018. While most expenses decreased during fiscal year 2019, insurance costs and building repairs increased due to the hurricane.

Beginning in the Fall of 2018, under the statutory authority of the Commodity Credit Corporation, the U.S. Department of Agriculture (USDA) is administering a Trade Mitigation Food Purchase and Distribution Program (Trade Mitigation Food Program) to purchase up to \$1.2 billion in USDA Foods. The bulk of this food is being distributed through The Emergency Food Assistance Program (TEFAP), which is USDA's primary outlet for foods purchased through market support mechanisms. Additionally, USDA is making Commodity Credit Corporation funds available to assist with the operational costs of the receipt, storage and distribution of these foods. For this fiscal year, the Houston Food Bank has distributed 8,987,905 pounds of food under the Trade Mitigation Food Program.

The Houston Food Bank and Subsidiaries

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

Principles of Consolidation

The consolidated financial statements includes the assets, liabilities, net assets, and activities of The Houston Food Bank and its wholly owned consolidated subsidiaries, the Endowment, MBKFF and QALICB, (collectively, "The Food Bank"). All significant intercompany account balances and transactions have been eliminated in the consolidated financial statements.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues, expenses, gains, losses and other changes in net assets during the reporting period. Actual results could differ from those estimates.

Cash

At June 30, 2019, The Food Bank's cash accounts exceeded federally insured limits per institution by approximately \$4,498,000.

Accounts Receivable

Accounts receivable consists of receivables outstanding at year-end from government grants and contracts and agencies. An allowance for accounts receivable and pledges receivable is provided when management determines the balance may not be collected in full. It is The Food Bank's policy to write off receivable 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 each period. It is possible that management's estimate regarding collectability of the balances will change in the near term resulting in a change in the carrying value of accounts receivable. No allowance was recorded as of June 30, 2019 and 2018.

Pledges Receivable

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. The allowance is determined using a combination of historical loss experience and individual account-by-account analysis of pledges receivable balances each period. It is possible that management's estimate regarding collectability of the balances will change in the near term resulting in a change in the carrying value of pledges receivable.

Food and Other Supplies

Food and other supplies consist primarily of canned goods, produce and durable household goods. Donated food supplies are valued at the weighted-average wholesale value of one pound of donated product based on the national per-pound price as provided by the most recent Feeding

The Houston Food Bank and Subsidiaries

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

America Product Valuation Survey. Purchased food is valued at the cost of products purchased as determined by the first-in, first-out method. Food and other supplies 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 food and other supplies and as contributions in these consolidated financial statements. Food and other supplies are recognized as expense when distributed.

Notes Receivable

Notes receivable are reported at their outstanding principal balance. Notes receivable are 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 notes receivable is recognized over the term of the notes receivable and is calculated using the simple-interest method on principal amounts outstanding.

Investments and Investment Return

Investments are reported at fair value. Investment return is reported in the consolidated statements of activities as an increase in net assets without donor restrictions 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 net assets with donor restrictions. Investment return includes dividend, interest and other investment income; realized and unrealized gains and losses on investments carried at fair value; and realized gains and losses on other investments. Other investment return is reflected in the statements of activities with or without donor restrictions based upon the existence and nature of any donor or legally imposed restrictions.

The Food Bank maintains pooled investment accounts for its endowments. Investment income and realized and unrealized gains and losses from securities in the pooled investment accounts are allocated to the individual endowments based on the relationship of the fair value of the interest of each endowment to the total fair value of the pooled investments accounts, as adjusted for additions to or deductions from those accounts.

Property and Equipment

Property and equipment are reported at cost, if purchased, or at fair value at the date of gift, if donated. Depreciation is provided on a straight-line basis over estimated useful lives of 39 to 45 years for buildings and three to five years for furniture, equipment and motor vehicles. Assets under capital lease obligations and leasehold improvements are depreciated over the shorter of the lease term or their respective estimated useful lives.

The Houston Food Bank and Subsidiaries

Notes to Consolidated Financial Statements

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Long-lived Asset Impairment

The Food Bank evaluates the recoverability of the carrying value of long-lived assets whenever events or circumstances indicate the carrying amount may not be recoverable. If a long-lived asset is tested for recoverability and the undiscounted estimated future cash flows expected to result from the use and eventual disposition of the asset are less than the carrying amount of the asset, the asset cost is adjusted to fair value and an impairment loss is recognized as the amount by which the carrying amount of a long-lived asset exceeds its fair value.

No asset impairment was recognized during the years ended June 30, 2019 and 2018.

Net Assets Classification

Net assets, revenues, gains and losses are classified based on the existence or absence of donor restrictions.

Net assets without donor restrictions are available for use in general operations and not subject to donor restrictions. The governing board has designated, from net assets without donor restrictions, net assets for an operating reserve and board-designated endowment.

Net assets with donor restrictions are subject to donor restrictions. Some restrictions are temporary in nature, such as those that will be met by the passage of time or other events specified by the donor. Other restrictions are perpetual in nature, where the donor stipulates that resources be maintained in perpetuity.

Contributions

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 must be maintained. The Food Bank reports expirations of donor restrictions when the donated or acquired long-lived assets are placed in service. Gifts and investment income that are originally restricted by the donor and for which the restriction is met in the same time period are recorded as donor restricted and then released from restriction.

Gifts of land, buildings, equipment and other long-lived assets are reported as revenue and net assets without donor restrictions unless explicit donor stipulations specify how such assets must be used, in which case the gifts are reported as donor restricted revenue and net assets. Absent explicit donor stipulations for the time long-lived assets must be held, expirations of restrictions resulting in reclassification of donor restricted net assets as net assets without donor restrictions are reported when the long-lived assets are placed in service.

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Unconditional gifts expected to be collected within one year are reported at their net realizable value. Unconditional gifts expected to be collected in future years are initially reported at fair value determined using the discounted present value of estimated future cash flows technique. The resulting discount is amortized using the level-yield method and is reported as contribution revenue.

Conditional gifts depend on the occurrence of a specified future and uncertain event to bind the potential donor and are recognized as assets and revenue when the conditions are substantially met and the gift becomes unconditional.

Noncash Contributions

Donated materials and use of facilities are recognized at fair value as contribution when an unconditional commitment is received from the donor. The related expense is recognized as the item is used. Contributions of services are recognized as revenue at their estimated fair value only when the services received create or enhance nonfinancial assets or require specialized skills possessed by the individuals providing the service and the service would typically need to be purchased if not donated. 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 consolidated financial statements because the donated services did not meet the criteria for recognition under accounting principles generally accepted in the United States of America (GAAP). In fiscal years 2019 and 2018, volunteers contributed approximately 623,000 hours and 518,000 hours (unaudited), respectively, to The Food Bank.

Government Grants and Contracts

Support funded by grants is recognized as The Food Bank meets the conditions prescribed by the grant agreement, distributes commodities, performs the contracted services or incurs outlays eligible for reimbursement under the grant agreements. Grant activities and outlays are subject to audit and acceptance by the granting agency and, as a result of such audit, adjustments could be required.

Agency Fees

Agency fees represent fees charged to agencies for handling of distributed food and are recognized when shipments of food are made to the agencies.

Sales of Purchased Food

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

Advertising Costs

Advertising costs are expensed as incurred.

The Houston Food Bank and Subsidiaries

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Income Taxes

The Houston Food Bank, the Endowment and MBKFF are exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code. The Houston Food Bank is classified as a public charity under Section 170(b)(1)(A)(vi). The Endowment and MBKFF are classified as Type I supporting organization under Section 509(a)(3).

Functional Allocation of Expenses

The costs of supporting the various program services and other activities have been summarized on a functional basis in the consolidated statements of activities. Certain costs have been allocated among program services, management and general, and fund-raising categories based on management determination of the nature of the costs and employee time expended.

To enhance our Food Distribution program activity, the Houston Food Bank also offers several programs that are designed to aid in distributing food and services to the most At-Risk in our communities. Our consolidated statement of functional expenses has been segregated by these specific program initiatives.

Child Hunger Initiatives includes programs developed to reach more children in schools, day care and other places that feed and care for underprivileged children.

Backpack Buddy program provides food to children at school locations in backpacks that they can take home at the end of the week to help feed the entire family.

Kids Cafe program is a collaboration of chefs, dietitians, students and volunteers. The mission of *Kids Cafe* is to help alleviate child hunger in America by providing hungry children with nutritious meals at times when other resources are not available, such as afterschool, on the weekends, and during the summer. *Kids Cafe* programs provide free meals and snacks to low-income children through a variety of existing community locations where children congregate.

School Market program helps alleviate child hunger in our community by providing food to children and their families. School-based markets are located on the grounds of a school to provide an easily accessible source of food assistance.

Client Assistance Programs

Client Assistance Program (CAP) provides application assistance for SNAP (*Supplemental Nutrition Assistance Program*) and other social, health, and personal services at the main office, by phone and at locations all around the greater Houston area. Referral services include a food pantry near the client, medical prescription assistance, utility assistance, cell phone assistance and rental assistance. Services are available in English and Spanish and may be provided in other languages via state interpretation services as needed.

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Nutrition Education program was developed to address food insecurity and hunger by using USDA materials and guidelines to achieve nutritional goals. Healthy nutrition habits promote health and reduce risk of diseases, such as diabetes. Classes are offered to our partner agencies and community organizations and revolve around USDA *Healthy Eating with MyPlate* and physical fitness. Each class features a cooking demo highlighting the material of the class.

The *Senior Box* program is a federal initiative designed to improve the health and nutrition of income eligible seniors. *Senior Box* program participants receive one box of food per month with an average retail value of \$50, which includes fruit juice/shelf-stable 2 percent milk, cereal, canned protein (e.g., chicken, chili, stew), pasta, canned vegetables/fruit, non-fat dried milk, bag of dried beans or jar of peanut butter and a two-pound block of cheese.

Other Program Initiatives

Food for Change is an innovative strategy that goes beyond emergency food assistance to address the root causes of hunger. The Houston Food Bank is at the forefront of efforts by food banks to use food as a catalyst – in partnership with social service programs – to help individuals achieve their life goals focusing on two related areas: health-related and economic opportunities.

Teachers Aid program provides the supplies kids need to succeed. Many children can not afford the most basic school supplies. Without the proper tools to do the work, children are challenged to achieve academic success. Many compassionate teachers pay for school supplies from their own pockets so that their students have a more productive, efficient learning experience. The *Teacher's Aid* program allows teachers to shop for supplies at a central location at no cost.

The Houston Food Bank's offers a *Culinary Training* program, where students learn to become chefs. They have opportunities to practice preparing dishes for sale at the *Texan's Café* located at the Food Bank or for catering events. At the end of the training, several popular restaurants and hotels are invited to taste dishes prepared by the students and interview for possible employment.

Change in Accounting Principle

On August 18, 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-14, *Not-for-Profit Entities* (Topic 958): *Presentation of Financial Statements of Not-for-Profit Entities*. In 2019, The Food Bank adopted ASU 2016-14. This change had no impact on previously reported total change in net assets. The changes are summarized as follows.

Consolidated Statement of Financial Position

The consolidated statement of financial position distinguishes between two new classes of net assets—those with donor-imposed restrictions and those without. This is a change from the previously required three classes of net assets—unrestricted, temporarily restricted and permanently restricted.

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Notes to Consolidated Financial Statements
June 30, 2019 and 2018

Consolidated Statement of Activities

Net investment income is shown net of external investment expenses. Disclosure of the expenses netted against net investment income is no longer required.

Consolidated Statement of Functional Expenses

This statement presents expenses by both nature and function in one location.

Notes to the Consolidated Financial Statements

Enhanced quantitative and qualitative disclosures provide additional information useful in assessing liquidity and cash flows available to meet operating expenses for one year from the date of the consolidated statement of financial position. Amounts and purposes of governing board designations and appropriations as of the end of the year are disclosed.

Reclassifications

Certain reclassifications have been made to the 2018 consolidated financial statements to conform to the 2019 consolidated financial statement presentation. These reclassifications had no effect on the change in net assets.

Note 2: Pledges Receivable

Pledges receivable consisted of the following as of June 30, 2019 or 2018:

	2019	2018
Total pledges receivable	\$ 1,888,767	\$ 2,904,810
Allowance for uncollectible pledges receivable	(190,000)	(274,194)
Discount to estimated present value at 0.41% to 2.73%	<u>(24,893)</u>	<u>(24,893)</u>
Pledges receivable, net	<u>\$ 1,673,874</u>	<u>\$ 2,605,723</u>

Pledges receivable at June 30, 2019, are scheduled to be collected as follows:

Receivable in one year	\$ 238,460
Receivable in one year to five years	<u>1,650,307</u>
Total pledges receivable	<u>\$ 1,888,767</u>

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Notes to Consolidated Financial Statements
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At June 30, 2019 and 2018, approximately 25 percent and 54 percent, respectively, of pledges receivable are due from one and four donors, respectively.

Note 3: Investments

Investments at June 30, 2019 and 2018, consisted of the following:

	2019	2018
Debt securities	\$ 3,446,305	\$ 3,096,790
Common stock	3,318,801	2,987,240
International equity mutual funds	1,616,302	1,587,592
Domestic equity mutual funds	1,151,706	1,088,365
Asset-backed securities	145,948	171,583
Money market mutual funds	<u>322,855</u>	<u>428,642</u>
 Total investments	 <u>\$ 10,001,917</u>	 <u>\$ 9,360,212</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 consolidated statements of financial position and consolidated statements of activities.

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

	2019	2018
Interest and dividends earned on investments	\$ 258,383	\$ 188,748
Interest earned on notes receivable	173,856	173,856
Realized and unrealized gain on investments	<u>446,757</u>	<u>439,464</u>
 Total investments return	 <u>\$ 878,996</u>	 <u>\$ 802,068</u>

Note 4: Disclosures About Fair Value of Assets and Liabilities

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. Fair value measurements must maximize the use of observable inputs and minimize the use of unobservable inputs. There is a hierarchy of three levels of inputs that may be used to measure fair value.

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Notes to Consolidated Financial Statements

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- Level 1** Quoted prices in active markets for identical assets or liabilities.
- Level 2** Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3** Unobservable inputs supported by little or no market activity and are significant to the fair value of the assets or liabilities.

Recurring Measurements

The following tables present the fair value measurements of assets recognized in the accompanying consolidated statements of financial position measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at June 30, 2019 and 2018:

	2019				Total
	Level 1	Level 2	Level 3	Total	
Common stock:					
American depository receipt	\$ 224,379	\$ -	\$ -	\$ 224,379	
Communication services	485,739	-	-	485,739	
Consumer discretionary	201,556	-	-	201,556	
Consumer staples	375,124	-	-	375,124	
Energy	187,932	-	-	187,932	
Financial	430,131	-	-	430,131	
Healthcare	300,419	-	-	300,419	
Industrial	236,151	-	-	236,151	
Information technology	774,011	-	-	774,011	
Materials	103,359	-	-	103,359	
Debt securities:					
Corporate bonds and notes	-	1,768,099	-	1,768,099	
Municipal bonds	-	1,678,206	-	1,678,206	
Domestic equity mutual funds:					
Large-cap	822,788	-	-	822,788	
Small/mid-cap	328,918	-	-	328,918	
International equity mutual funds:					
Large-cap	932,986	-	-	932,986	
Strategic	493,888	-	-	493,888	
Emerging markets	189,428	-	-	189,428	
Asset-backed securities	-	145,948	-	145,948	
Money market mutual funds	<u>322,855</u>	<u>-</u>	<u>-</u>	<u>322,855</u>	
Total assets measured at fair value	<u><u>\$ 6,409,664</u></u>	<u><u>\$ 3,592,253</u></u>	<u><u>\$ 0</u></u>	<u><u>\$ 10,001,917</u></u>	

The Houston Food Bank and Subsidiaries
Notes to Consolidated Financial Statements
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	2018			
	Level 1	Level 2	Level 3	Total
Common stock:				
American depository receipt	\$ 224,970	\$ -	\$ -	\$ 224,970
Consumer discretionary	633,677	-	-	633,677
Consumer staples	400,110	-	-	400,110
Energy	199,931	-	-	199,931
Financial	459,982	-	-	459,982
Healthcare	221,003	-	-	221,003
Industrial	193,289	-	-	193,289
Information technology	572,036	-	-	572,036
Materials	82,242	-	-	82,242
Debt securities:				
Corporate bonds and notes	- -	1,754,515	-	1,754,515
Governmental bonds and notes	- -	49,852	-	49,852
Municipal bonds	- -	1,292,423	-	1,292,423
Domestic equity mutual funds:				
Large-cap	771,989	-	-	771,989
Small/mid-cap	316,376	-	-	316,376
International equity mutual funds:				
Large-cap	923,963	-	-	923,963
Strategic	478,146	-	-	478,146
Emerging markets	185,483	-	-	185,483
Asset-backed securities	- -	171,583	-	171,583
Money market mutual funds	428,642	-	-	428,642
Total assets measured at fair value	<u>\$ 6,091,839</u>	<u>\$ 3,268,373</u>	<u>\$ 0</u>	<u>\$ 9,360,212</u>

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

- Common stock is valued at the closing price reported on the active market on which the individual securities are traded.
- Debt securities and asset-backed 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 and 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.

Note 5: Notes Receivable

The Food Bank entered into an agreement on December 23, 2016, to lend \$4,763,187 to Twain Investment Fund 181, LLC (Twain Investment Fund). The note is secured by Twain Investment Fund's membership interest in Urban Development Fund 53, LLC (UDF CDE). The interest rate on the note is fixed as 3.65 percent. Interest is payable quarterly beginning January 2017 until

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December 2047. All principal and unpaid interest is due and payable in January 2047. The Food Bank may accelerate the maturity date of the note to December 2024 with a 30-day notice to Twain Investment Fund.

Interest earned on notes receivable in both 2019 and 2018 was approximately \$174,000.

Note 6: Payable to Bank

In September 2016, The Food Bank entered into a decreasing revolving promissory note with a bank to borrow up to \$4,300,000. During 2017, proceeds of \$4,300,000 from the note were used to finance the construction of a new kitchen. The note bore interest at 3.65 percent and was secured by accounts receivable, certain cash and investment accounts and \$750,000 of the proceeds from the sale of the property located at 2445 North Freeway (Keegan building). The loan was fully repaid during 2018, no amounts were drawn on the note during 2019 and there was no balance due as of June 30, 2019.

Note 7: Property and Equipment

Property and equipment consists of the following:

	2019	2018
Land	\$ 4,348,401	\$ 4,348,401
Buildings and improvements	51,072,179	51,052,677
Furniture and equipment	15,012,949	13,026,221
Motor vehicles	<u>17,767,948</u>	<u>15,364,037</u>
Total property and equipment, at cost	88,201,477	83,791,336
Less accumulated depreciation	<u>(25,341,961)</u>	<u>(19,804,227)</u>
Property and equipment, net	<u>\$ 62,859,516</u>	<u>\$ 63,987,109</u>

Note 8: Capital Lease Payable

Capital leases include leases covering 23 freightliners for seven years effective October 6, 2017, with monthly payments of \$49,904 including interest at 6.94 percent through April 2025. Aggregate annual maturities of payments on capital lease obligations at June 30, 2019, are as follows.

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	Capital Lease Obligations
2020	\$ 598,848
2021	598,848
2022	598,848
2023	598,848
2024	598,848
Thereafter	<u>449,361</u>
Less amount representing interest	<u>3,443,601</u> <u>(610,978)</u>
Present value of future minimum lease payments	<u>\$ 2,832,623</u>

Capitalized assets under the lease were \$2,721,342 and \$3,194,619, net of accumulated depreciation as of June 30, 2019 and 2018, respectively.

Note 9: New Market Tax Credits Notes Payable

QALICB executed loan agreement on December 23, 2016, that provided for borrowing of \$6,500,000 from UDF CDE. Proceeds from the loans were used to finance the construction of a new kitchen and are intended to be treated as a "qualified low-income community investment" for purpose 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 guaranty by The Food Bank. Under the terms of new market tax credits loan agreement, each loan accrues interest at 3.42 percent payable quarterly beginning in March 2017 with the principle balance in its entirety on January 1, 2047. QALICB is not permitted to prepay any portion of the loans until the seventh anniversary of the loan.

	2019	2018
Total new market tax credits notes payable	\$ 6,500,000	\$ 6,500,000
Less unamortized debt issuance costs	<u>(272,162)</u>	<u>(282,059)</u>
New market tax credits notes payable, net	<u>\$ 6,227,838</u>	<u>\$ 6,217,941</u>

The balances outstanding on the new market tax credits notes payable, maturity dates and repayment terms at June 30, 2019, are as follows.

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Note payable to UDF CDE Loan A, matures on January 1, 2047, with principal payments commencing in January 2024	\$ 4,763,187
Note payable to UDF CDE Loan B, matures on January 1, 2047, with principal payments commencing in January 2024	<u>1,736,813</u>
Total new market tax credits notes payable	<u><u>\$ 6,500,000</u></u>

At any time after the seventh anniversary but before the eighth anniversary of the note receivable, U.S. Bancorp Community Development Corporation can exercise its "put option" to sell its interest in Twain Investment to The Food Bank for \$1,000. After exercising its option to purchase the interest in the Twain Investment Fund, The Food Bank may cancel the new market tax credits notes payable.

Interest recognized as expense totaled approximately \$222,000 in both 2019 and 2018.

Note 10: Net Assets

Net Assets With Donor Restrictions

Net assets with donor restrictions at June 30 are restricted for the following purposes or periods:

	2019	2018
Subject to expenditure for specified purpose:		
Child hunger initiatives	\$ 772,087	\$ 213,570
Food distribution	993,289	-
Other programs	<u>771,219</u>	<u>1,043,816</u>
	<u><u>2,536,595</u></u>	<u><u>1,257,386</u></u>
Subject to the passage of time:		
Promises to give that are not restricted by donors but which are unavailable for expenditure until due	<u>1,094,183</u>	<u>1,207,204</u>
Endowments:		
Subject to appropriation and expenditure	455,941	357,674
Original donor-restricted gift amounts required to be maintained in perpetuity by donor	<u>961,390</u>	<u>961,390</u>
Total endowments	<u><u>1,417,331</u></u>	<u><u>1,319,064</u></u>
Total	<u><u>\$ 5,048,109</u></u>	<u><u>\$ 3,783,654</u></u>

Net Assets Without Donor Restrictions

Net assets without donor restrictions at June 30 are as follows.

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June 30, 2019 and 2018

	2019	2018
Undesignated	\$ 86,802,291	\$ 95,885,406
Board-designated - quasi-endowment for general operations	<u>5,827,455</u>	<u>5,422,929</u>
Net assets without donor restrictions	<u><u>\$ 92,629,746</u></u>	<u><u>\$ 101,308,335</u></u>

Net Assets Released from Restrictions

Net assets were released from donor restrictions by incurring expenses satisfying the restricted purposes or by occurrence of other events specified by donors as follows:

	2019	2018
Expiration of time restrictions	<u>\$ 957,777</u>	<u>\$ 275,919</u>
Satisfaction or purpose restrictions:		
Child hunger initiatives	1,538,672	1,831,141
Food distribution	984,099	46,362,480
Client assistance program	78,997	137,304
Other programs	<u>1,282,171</u>	<u>768,622</u>
	<u>3,883,939</u>	<u>49,099,547</u>
	<u><u>\$ 4,841,716</u></u>	<u><u>\$ 49,375,466</u></u>

Note 11: Endowment

The Food Bank's endowment includes both donor-restricted endowment funds and funds designated by the governing body to function as endowments (Board-designated endowment funds). As required by GAAP, net assets associated with endowment funds, including Board-designated endowment funds, are classified and reported based on the existence or absence of donor-imposed restrictions.

The Board of the Endowment has 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 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 net assets with donor restrictions. The remaining portion of the donor-restricted endowment are reported as net assets with donor restrictions until those amount are appropriated for expenditure by the Endowment in a manner consistent with the standard of prudence prescribe by TUPMIFA. In accordance with TUPMIFA, the Endowment considers the following factors in making a determination appropriate or accumulate donor-restricted endowment funds:

1. The duration and preservation of the funds.
2. The purpose of The Food Bank and the donor-restricted endowment funds.

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3. General economic conditions.
4. The possible effect of inflation and deflation.
5. The expected total return from income and the appreciation of investment.
6. Other resources of The Food Bank.
7. The investment policies 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. Under the policy, as approved by the Board, 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 percent 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 percent, plus the annual rate of inflation over any 10-year period.

Strategies Employed for Achieving Objectives

To satisfy its 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 its long-term return objectives within prudent risk constraints.

Spending Policy

The Endowment has a policy of not appropriating more than 5 percent 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. In accordance with GAAP, deficiencies of this nature are reported in net assets with donor restrictions. These deficiencies resulted from unfavorable market fluctuations that occurred shortly after investment of new contributions without donor restrictions and continued appropriation for certain purposes that was deemed prudent by the governing body.

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Endowment net asset composition as of June 30, 2019, is as follows:

	Without Donor Restrictions	With Donor Restrictions	Total
Board-designated endowment funds	\$ 5,827,455	\$ -	\$ 5,827,455
Donor-restricted endowment funds:			
Original donor-restricted gift amount and amounts required to be maintained in perpetuity by donor	- -	961,390 455,941	961,390 455,941
Accumulated investment gains	- -	455,941	455,941
Endowment net assets	\$ 5,827,455	\$ 1,417,331	\$ 7,244,786

Endowment net asset composition as of June 30, 2018, is as follows:

	Without Donor Restrictions	With Donor Restrictions	Total
Board-designated endowment funds	\$ 5,422,929	\$ -	\$ 5,422,929
Donor-restricted endowment funds:			
Original donor-restricted gift amount and amounts required to be maintained in perpetuity by donor	- -	961,390 357,674	961,390 357,674
Accumulated investment gains	- -	357,674	357,674
Endowment net assets	\$ 5,422,929	\$ 1,319,064	\$ 6,741,993

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

	Without Donor Restrictions	With Donor Restrictions	Total
Endowment net assets, June 30, 2017	\$ 4,929,262	\$ 1,185,351	\$ 6,114,613
Investment return, net:			
Interest and dividends	97,010	23,328	120,338
Net realized and unrealized gain	427,681	102,845	530,526
Investment management fees	(31,024)	(7,460)	(38,484)
Total investment return, net	493,667	118,713	612,380
Contributions	0	15,000	15,000
Endowment net assets, June 30, 2018	5,422,929	1,319,064	6,741,993
Contributions	530	0	530
Investment return, net:			
Interest and dividends	105,298	25,612	130,910
Net realized and unrealized gain	337,850	82,178	420,028
Investment management fees	(39,152)	(9,523)	(48,675)
Total investment return, net	403,996	98,267	502,263
Endowment net assets, June 30, 2019	\$ 5,827,455	\$ 1,417,331	\$ 7,244,786

The Houston Food Bank and Subsidiaries
Notes to Consolidated Financial Statements
June 30, 2019 and 2018

Note 12: Noncash Contributions

Food Donations

The majority of food distributed by The Food Bank is received by contributions from the general public, the USDA and the U.S. Department of Homeland Security (USDHS). The estimated value of these contributions is recognized in the consolidated financial statements as contribution revenue and food and other supplies 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. For the year ended June 30, 2019, The Food Bank separately valued food donations and combined food and household items separately as shown below. In prior years, all general donations were valued together as combined food and household items. The total value of contributed food for the years ended June 30, 2019 and 2018, is as follows:

	2019			2018		
	Pounds	Value Per Pound	Amount	Pounds	Value Per Pound	Amount
General donations - food and household items	26,269,042	\$1.62	\$ 42,555,848	100,710,759	\$1.68	\$ 169,194,075
General donations - food	38,376,177	\$1.52	58,331,789	-	-	-
USDA	45,219,056	\$1.52	68,732,965	25,139,416	\$1.57	39,468,882
USDHS	225	\$1.52	342	26,683,014	\$1.57	41,892,332
Total	<u>109,864,500</u>		<u>\$ 169,620,944</u>	<u>152,533,189</u>		<u>\$ 250,555,289</u>

Other Donations

During 2019, The Food Bank received \$444,218 of other donated property, goods and services, including \$375,572 of baseball tickets, and \$68,646 of miscellaneous goods and services. During 2018, The Food Bank received \$1,695,081 of other donated property, goods and services, including \$318,040 of baseball tickets, a \$300,000 truck, \$193,786 of trailers, \$650,000 of consulting hours, and \$233,255 of miscellaneous goods and services

Note 13: Government Grants and Contracts

The Food Bank is party to contracts with federal and state government 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 and grants and contracts are as follows.

The Houston Food Bank and Subsidiaries
Notes to Consolidated Financial Statements
June 30, 2019 and 2018

	2019	2018
Administrative costs:		
U.S. Department of Agriculture	\$ 11,632,537	\$ 6,747,187
Texas Health and Human Services Commission	1,069,811	1,237,401
Texas Department of Agriculture	<u>1,118,665</u>	<u>881,344</u>
Total federal and state grants and contracts	13,821,013	8,865,932
Commodities:		
U.S. Department of Homeland Security	342	41,892,332
U.S. Department of Agriculture	<u>68,732,965</u>	<u>39,468,882</u>
Total government grants and contracts	<u>\$ 82,554,320</u>	<u>\$ 90,227,146</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 noncompliance 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 14: 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 included two five-year renewal options. The following is a schedule of future rent income of June 30, 2019:

2020	\$ 903,706
2021	944,322
2022	944,322
2023	944,322
2024	954,476
Thereafter through 2030	<u>5,503,468</u>
Total	<u><u>\$ 10,194,616</u></u>

Rental income of \$890,665 and \$1,544,001 has been recognized in the consolidated financial statements related to this lease agreement for 2019 and 2018, respectively.

The Houston Food Bank and Subsidiaries

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

Note 15: Industrial Lease

The Food Bank entered into an industrial lease for warehouse space on September 1, 2017, as amended on February 16, 2018. The lease expired on June 30, 2019. Rental expense of \$504,000 and \$378,000 has been recognized in the consolidated financial statements related to this lease agreement for the years ended June 30, 2019 and 2018, respectively.

Note 16: Employee Pension Plan

The Food Bank has a defined contribution 401(k) plan for employees who meet certain length of service requirements. The Food Bank matches 50 percent of employees' contribution up to 6 percent of the employee's compensation. Defined contributions made by The Food Bank vest at the end of the year. The Food Bank's contributions to the plan were \$295,028 and \$264,123 for the years ended June 30, 2019 and 2018, respectively.

Note 17: Related-party Transactions

A Board member of The Food Bank is an employee of a produce company to which The Food Bank paid approximately \$45,000 and \$18,000 during 2019 and 2018, respectively, related to the purchase of produce. Another Board member of The Food Bank is an employee of a food distribution company to which The Food Bank paid approximately \$16,000 and \$934,000 during 2019 and 2018, respectively, related to food distribution.

Note 18: Liquidity and Availability

Financial assets available for general expenditure, that is, without donor or other restrictions limiting their use, within one year of June 30, 2019 and 2018, comprise the following:

	2019	2018
Total financial assets	\$ 14,687,074	\$ 28,189,187
Less those unavailable for general expenditures within one year, due to:		
Donor-imposed restrictions:		
Donor-restricted endowments	<u>(1,417,331)</u>	<u>(1,319,064)</u>
Financial assets available to meet cash needs for general expenditures within one year	<u>\$ 13,269,743</u>	<u>\$ 26,870,123</u>

The Houston Food Bank and Subsidiaries

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

The Food Bank receives significant contributions restricted by donors and considers contributions restricted for programs which are ongoing, major and central to its annual operations to be available to meet cash needs for general expenditures. For the years ended June 30, 2019 and 2018, restricted contributions of \$4,786,019 and \$4,783,000, respectively, were included in financial assets available to meet cash needs for general expenditures within one year.

The Food Bank's endowment funds consist of donor-restricted endowments and funds designated by the board as endowments. Income from donor-restricted endowments is restricted for specific purposes, with the exception of the amounts available for general use. Donor-restricted endowment funds are not available for general expenditure.

The board-designated endowment of \$5,827,455 is subject to an annual spending rate of 5 percent as described in Note 10. Although The Food Bank does not intend to spend from this board-designated endowment (other than amounts appropriated for general expenditure as part of the Board's annual budget approval and appropriation), these amounts could be made available if necessary.

The Food Bank manages its liquidity and reserves following three guiding principles: operating within a prudent range of financial soundness and stability, maintaining adequate liquid assets to fund near-term operating needs and maintaining sufficient reserves to provide reasonable assurance that long-term obligations will be discharged. The Board has a designated endowment to help meet the operating needs of The Food Bank. To achieve this target, The Food Bank forecasts its future cash flows and monitors its liquidity monthly and monitors its reserves annually.

Note 19: Subsequent Events

Subsequent events have been evaluated through October 31, 2019, which is the date the consolidated financial statements were available to be issued.

Note 20: Future Change in Accounting Principle

Revenue Recognition

The FASB amended its standards related to revenue recognition. This amendment replaces all existing revenue recognition guidance and provides a single, comprehensive revenue recognition model for all contracts with customers. The guidance provides a five-step analysis of transactions to determine when and how revenue is recognized. Other major provisions include capitalization of certain contract costs, consideration of the time value of money in the transaction price and allowing estimates of variable consideration to be recognized before contingencies are resolved in certain circumstances. The amendment also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in those judgments and assets recognized from costs incurred to fulfill a contract. The standard allows either full or modified retrospective adoption

The Houston Food Bank and Subsidiaries

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

effective for nonpublic entities for annual periods beginning after December 15, 2018 (December 15, 2017, for not-for-profits that are conduit debt obligors), and any interim periods within annual reporting periods that begin after December 15, 2019 (December 15, 2018, for not-for-profits that are conduit debt obligors). The Food Bank will implement the ASU for the fiscal year ended 2020 and is in the process of evaluating the effect the amendment will have on the consolidated financial statements.

Accounting for Leases

The FASB amended its standard related to the accounting for leases. Under the new standard, lessees will now be required to recognize substantially all leases on the statements of financial position as both a right-of-use asset and a liability. The standard has two types of leases for statements of activities recognition purposes: operating leases and finance leases. Operating leases will result in the recognition of a single lease expense on a straight-line basis over the lease term similar to the treatment for operating leases under existing standards. Finance leases will result in an accelerated expense similar to the accounting for capital leases under existing standards. The determination of lease classification as operating or finance will be done in a manner similar to existing standards. The new standard also contains amended guidance regarding the identification of embedded leases in service contracts and the identification of lease and nonlease components in an arrangement. The new standard is effective for annual periods beginning after December 15, 2020, and any interim periods within annual reporting periods that begin after December 15, 2021. The Food Bank will implement the new ASU for the fiscal year ended 2022 evaluating the effect the standard will have on the consolidated financial statements; however, the standard is expected to have a material effect on the consolidated financial statements due to the recognition of additional assets and liabilities for operating leases.

Supplementary Information

The Houston Food Bank and Subsidiaries
Schedule of Expenditures of Federal Awards
Year Ended June 30, 2019

Federal Grantor/Pass-through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-through Entity Identifying Number	Passed Through to Subrecipients	Total Federal Expenditures
U.S. Department of Agriculture				
SNAP Cluster:				
Passed-through Texas Health and Human Services Commission:				
State Administrative Matching Grants for the Supplemental Nutrition Assistance Program				
10/01/17 - 09/30/18	10.561	74N7009	\$	\$ 160,574
10/01/18 - 09/30/19	10.561	74N7009	-	429,749
Total State Administrative Matching Grants for the Supplemental Nutrition Assistance Program			0	590,323
Total Passed-through Texas Health and Human Services Commission			0	590,323
Passed through Brighter Bites:				
Brighter Bites Program:				
10/01/17 - 09/30/18	10.561	SASS-16-004	-	5,721
10/01/18 - 09/30/19	10.561	SASS-16-004	-	41,520
Total Brighter Bites Program			0	47,241
Total SNAP Cluster			0	637,564
Passed through Texas Department of Agriculture:				
Trade Mitigation Food Purchase and Distribution Program:				
10/01/18 - 09/30/19	10.178	01534	-	1,536,812
Total Trade Mitigation Food Purchase and Distribution Program			0	1,536,812
Child and Adult Care Food Program:				
10/01/17 - 09/30/18	10.558	101-01534	-	315,467
10/01/18 - 09/30/19	10.558	101-01534	-	2,245,598
Total Child and Adult Care Food Program			0	2,561,065
Child Nutrition Cluster:				
Summer Food Service Program for Children:				
10/01/17 - 09/30/18	10.559	101-01534	-	870,751
10/01/18 - 09/30/19	10.559	101-01534	-	739,000
Total Summer Food Service Program for Children			0	1,609,751
Total Child Nutrition Cluster			0	1,609,751
Food Distribution Cluster:				
Commodity Supplemental Food Program:				
10/01/17 - 09/30/18	10.565	TX-101-4001	-	322,325
10/01/18 - 09/30/19	10.565	TX-101-4001	-	884,612
10/01/17 - 09/30/18	10.565	TX-101-4001	1,388,260	1,388,260 *
10/01/18 - 09/30/19	10.565	TX-101-4001	4,349,393	4,349,393 *
Total Commodity Supplemental Food Program			5,737,653	6,944,590

*Amount represents noncash food commodities

The Houston Food Bank and Subsidiaries
Schedule of Expenditures of Federal Awards (Continued)
Year Ended June 30, 2019

Federal Grantor/Pass-through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-through Entity Identifying Number	Passed Through to Subrecipients	Total Federal Expenditures
Food Distribution Cluster (Continued):				
Emergency Food Assistance Program (Administrative Costs):				
10/01/18 - 09/30/19 - Disaster Assistance	10.568	01534	\$ -	\$ 338,088
10/01/17 - 09/30/18	10.568	TX-101-7058	-	707,850
10/01/18 - 09/30/19	10.568	TX-101-7058	-	2,784,511
Total Emergency Food Assistance Program (Administrative Costs)			0	3,830,449
Emergency Food Assistance Program (Food Commodities):				
10/01/17 - 09/30/18 - Disaster Assistance	10.569	01534	9,533	9,533 *
10/01/18 - 09/30/19 - Disaster Assistance	10.569	01534	2,028,905	2,028,905 *
10/01/18 - 09/30/19 - Trade Mitigation	10.569	01534	14,399,614	14,399,614 *
10/01/17 - 09/30/18	10.569	101-0452K9	4,781,539	4,781,539 *
10/01/18 - 09/30/19	10.569	101-0452K9	30,478,441	30,478,441 *
Total Emergency Food Assistance Program (Food Commodities)			51,698,032	51,698,032
Total Food Distribution Cluster			57,435,685	62,473,071
Total Passed-through Texas Department of Agriculture			57,435,685	68,180,699
Total U.S. Department of Agriculture			<u><u>\$ 57,435,685</u></u>	<u><u>\$ 68,818,263</u></u>
U.S. Department of Homeland Security				
Passed-through the Department of Public Safety and Texas Division of Emergency Management-Disaster Grants - Public Assistance (Presidentially Declared Disasters):				
10/01/17 - 09/30/18	97.036	FEMA-4332-DR-TX	360,673	360,673 *
10/01/18 - 09/30/19	97.036	FEMA-4332-DR-TX	209,454	209,454 *
Total U.S. Department of Homeland Security			570,127	570,127
Total Expenditures of Federal Awards			<u><u>\$ 58,005,812</u></u>	<u><u>\$ 69,388,390</u></u>

*Amount represents noncash food commodities

The Houston Food Bank and Subsidiaries
Schedule of Expenditures of State Awards
Year Ended June 30, 2019

State Grantor/Pass-through Grantor/Program or Cluster Title	Pass-through Entity Identifying Number	Passed Through to Subrecipients	Total State Expenditures
Texas Department of Agriculture			
Passed-through Brighter Bites:			
Brighter Bites Program:			
10/01/17 - 09/30/18	SASS-16-004	\$ -	\$ 4,613
10/01/18 - 09/30/19	SASS-16-004	\$ -	\$ 636
Total Passed-through Brighter Bites		\$ 0	<u>5,249</u>
Passed-through Feeding Texas:			
Texans Feeding Texans: Surplus Agriculture Products Grant Program:			
10/01/17 - 09/30/18	AS-1819-01	\$ 0	\$ 974,500
Total Passed-through Feeding Texas		\$ 0	<u>974,500</u>
Total Texas Department of Agriculture		\$ 0	<u>979,749</u>
Total Expenditures of State Awards		\$ 0	<u>\$ 979,749</u>

The Houston Food Bank and Subsidiaries
Notes to Schedule of Expenditures of Federal and State Awards
Year Ended June 30, 2019

Note 1: Significant Accounting Policies

The accompanying schedules of expenditures of federal and state awards (the Schedules) include the federal and state award activity of The Houston Food Bank and Subsidiaries (the Food Bank) under programs of the federal government and State of Texas for the year ended June 30, 2019. The information in the Schedules are presented in accordance with the requirements of Title 2 U.S. *Code of Federal Regulations (CFR)* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance) and the State of Texas *Uniform Grant Management Standards* (UGMS). Because the Schedules present only a selected portion of the operations of the Food Bank, they are not intended to and do not present the financial position, changes in net assets or cash flows of the Food Bank.

Expenditures reported on the Schedules are reported on the accrual basis of accounting. Such expenditures are recognized following the cost principles contained in the Uniform Guidance and UGMS, wherein certain types of expenditures are not allowable or are limited as to reimbursement. Negative amounts shown on the Schedules represent adjustments or credits made in the normal course of business to amounts reported as expenditures in prior years. The Food Bank has elected not to use the 10 percent de minimis indirect cost rate allowed under the Uniform Guidance.

Note 2: Food Commodities

Food commodities are expended when distributed to agencies. Distributed food is reported in the schedule of expenditures of federal awards under the Commodity Supplemental Food Program, TEFAP and Disaster Grants – Public Assistance and is valued at the weighted-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 (\$1.52 in 2019). As of June 30, 2019, \$14,140,412 and \$1,533,641 was included in food inventory for TEFAP and Commodity Supplemental Food Program, respectively, and had not been expended.

Note 3: Federal Loan Programs

The Food Bank did not have any federal loan programs during the year ended June 30, 2019.

**Report on Internal Control over Financial Reporting and on Compliance and
Other Matters Based on an Audit of Financial Statements Performed
in Accordance with *Government Auditing Standards***

Independent Auditor's Report

Board of Directors
The Houston Food Bank and Subsidiaries
Houston, Texas

We have audited, 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, the consolidated financial statements of The Houston Food Bank and Subsidiaries (the Food Bank), which comprise the consolidated statement of financial position as of June 30, 2019, and the related consolidated statements of activities, functional expenses and cash flows for the year then ended, and the related notes to the consolidated financial statements and have issued our report thereon dated October 31, 2019. Our report contained an "Emphasis of Matter" paragraph regarding a change in accounting principles.

Internal Control Over Financial Reporting

In planning and performing our audit of the consolidated financial statements, we considered the Food Bank's internal over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Food Bank's internal control. Accordingly, we do not express an opinion on the effectiveness of the Food Bank's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit, we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Food Bank's consolidated financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

BKD, LLP

Houston, Texas
October 31, 2019

Report on Compliance for Each Major Federal and State Programs and Report on Internal Control Over Compliance

Independent Auditor's Report

Board of Directors
The Houston Food Bank and Subsidiaries
Houston, Texas

Report on Compliance for each Major Federal and State Programs

We have audited The Houston Food Bank and Subsidiaries' (the Food Bank) compliance with the types of compliance requirements described in the *OMB Compliance Supplement* and in the State of Texas *Uniform Grant Management Standards* (UGMS) that could have a direct and material effect on the Food Bank's major federal and state programs for the year ended June 30, 2019. The Food Bank's major federal and state programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with federal and state statutes, regulations and the terms and conditions of its federal and state awards applicable to its federal and state programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for the Food Bank's major federal and state programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. *Code of Federal Regulations Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance) and UGMS. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal or state program occurred. An audit includes examining, on a test basis, evidence about the Food Bank's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for the major federal and state programs. However, our audit does not provide a legal determination of the Food Bank's compliance.

Opinion on Major Federal and State Programs

In our opinion, the Food Bank complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on its major federal and state programs for the year ended June 30, 2019.

Report on Internal Control over Compliance

Management of the Food Bank is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Food Bank's internal control over compliance with the types of requirements that could have a direct and material effect on the major federal and state programs to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for the major federal and state programs and to test and report on internal control over compliance in accordance with the Uniform Guidance and UGMS, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Food Bank's internal control over compliance.

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal or state program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal or state program will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal or state program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance and UGMS. Accordingly, this report is not suitable for any other purpose.

BKD, LLP

Houston, Texas
October 31, 2019

The Houston Food Bank and Subsidiaries
Schedule of Findings and Questioned Costs
Year Ended June 30, 2019

Summary of Auditor's Results

Financial Statements

1. The type of report the auditor issued on whether the financial statements audited were prepared in accordance with GAAP was (were):

Unmodified Qualified Adverse Disclaimer

2. The independent auditor's report on internal control over financial reporting disclosed:

Significant deficiency(ies)? Yes None reported

Material weakness(es)? Yes No

3. Noncompliance considered material to the financial statements was disclosed by the audit?

Yes No

Federal and State Awards

4. The independent auditor's report on internal control over compliance for major federal and state awards programs disclosed:

Significant deficiency(ies)? Yes None reported

Material weakness(es)? Yes No

5. The opinions expressed in the independent auditor's report on compliance for major federal and state awards were:

Unmodified Qualified Adverse Disclaimer

6. The audit disclosed findings required to be reported by 2 CFR 200.516(a)?

Yes No

7. The audit disclosed findings required to be reported by UGMS?

Yes No

The Houston Food Bank and Subsidiaries
Schedule of Findings and Questioned Costs (Continued)
Year Ended June 30, 2019

8. The Food Bank's major programs were:

Cluster/Program	CFDA Number
Name of State Program	Grantor Number
Federal:	
Food Distribution Cluster	
Commodity Supplemental Food Program	10.565
Emergency Food Assistance Program (Administrative Costs)	10.568
Emergency Food Assistance Program (Food Commodities)	10.569
Child and Adult Care Food Program (CACFP)	10.558

9. The threshold used to distinguish between Type A and Type B federal programs was \$2,081,443.

10. The threshold used to distinguish between Type A and Type B state programs was \$300,000.

11. The Food Bank qualified as a low-risk auditee? Yes No

Findings Required to be Reported by Government Auditing Standards

No matters are reportable.

Findings Required to be Reported by the Uniform Guidance or UGMS

No matters are reportable.

The Houston Food Bank and Subsidiaries
Summary of Schedule of Prior Year Audit Findings
Year Ended June 30, 2019

Reference Number	Summary of Finding	Status
2018-001	<p>Inventory</p> <p>Criteria or specific requirement: The Food Bank's internal controls should be designed to prevent, or detect and correct, misstatements on a timely basis.</p> <p>Condition: During our year-end inventory observation, we noted an error of approximately \$1.4 million dollars in the inventory balance as of year-end. The error was subsequently corrected.</p> <p>Effect: Potential material misstatement of financial statements.</p> <p>Cause: A barcode was scanned in on the weight field instead of count field, causing an overstatement in inventory.</p> <p>Recommendation: We recommend that management review the inventory listing at year-end for large variances that could be the result of scanning error.</p> <p>Views of responsible officials: The overstatement was caused by an employee error which was not discovered until the test counts during the audit of the inventory.</p> <p>Management's 2019 follow-up response: Before posting the final inventory, the management team checked the journal for large variances by looking at the Physical Inventory quantities over 1,000,000. Since this field is scanned while the pallet numbers are only seven digits long, it would show any line that had the scanned pallet number. Any necessary corrections were made prior to the actual physical inventory.</p>	Resolved
2018-002	<p>Subrecipient Monitoring</p> <p>U.S. Department of Homeland Security Passed through the Department of Public Safety and Texas Division of Emergency Management Disaster Grants - Public Assistance (Presidentially Declared Disasters) CFDA 97.036 Contract FEMA-4332-DR-TX Contract year 10/1/17-9/30/18</p>	Resolved

The Houston Food Bank and Subsidiaries
Summary of Schedule of Prior Year Audit Findings (Continued)
Year Ended June 30, 2019

Reference Number	Summary of Finding	Status
	<p>Criteria or specific requirement: Subrecipient monitoring - The Food Bank is responsible for providing federal award information to subrecipients and for monitoring the activities of subrecipients as necessary to ensure the sub award is used for authorized purposes, complies with the terms and conditions of the sub award, and achieves performance goals in compliance with 2 CFR Section 200.331 of the Uniform Guidance.</p> <p>Condition: The Food Bank did not provide the federal award identification number and award information required by 2 CFR section 200.331(a) sufficient for the subrecipient to comply with Federal statutes, regulations, and the terms and conditions of the award. The Food Bank did not document monitoring of subrecipients.</p> <p>Questioned costs: None.</p> <p>Context: We tested 25 of the 469 subrecipient awards, noting that none were provided with federal award number and information required related to compliance requirements. The sample selected was not, and was not intended to be, statistically valid. The Food Bank utilized volunteers to monitor subrecipient activities; however, no documentation was maintained to support the monitoring activity.</p> <p>Effect: Failure to provide the federal award identification number and award information as well as failure to document monitoring of subrecipient activities and compliance could result in material noncompliance with federal requirements.</p> <p>Cause: The Food Bank's response to Hurricane Harvey disaster recovery needs required a high volume of new agency award agreements to be executed in a very short amount of time in order to distribute FEMA food commodities to meet urgent needs. The agencies were monitored by volunteers; however, no specific documentation was maintained supporting this activity. There was a lack of understanding of the information that was required to be included in the subrecipient awards.</p> <p>Recommendation: Implement procedures to include providing all subrecipients with federal award identification and award information required by 2 CFR Section 200.331(a) and maintain documentation of monitoring of all subrecipients of federal awards.</p>	

The Houston Food Bank and Subsidiaries
Summary of Schedule of Prior Year Audit Findings (Continued)
Year Ended June 30, 2019

Reference Number	Summary of Finding	Status
	<p>Views of responsible officials: In response to Hurricane Harvey, many agencies were set up quickly to distribute food from FEMA. The agency agreements used for this purpose did not provide the federal identification and award information required. Agency agreements are updated annually, and this information will be included in all partner agreements going forward.</p> <p>Management's 2019 follow-up response:</p> <ol style="list-style-type: none">1. All partner agreements have been reviewed.2. Where necessary, new agreements were sent to replace current agreement.3. During annual monitoring visits, the new language has been reviewed, discussed and noted on the monitoring form.4. All new agency agreements have been stored and maintained electronically.	