

Houston Zoo, Inc.

Financial Statements
and Independent Auditors' Report
for the years ended December 31, 2018 and 2017

Houston Zoo, Inc.

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Independent Auditors' Report

To the Board of Directors of
Houston Zoo, Inc.:

We have audited the accompanying financial statements of Houston Zoo, Inc., which comprise the statements of financial position as of December 31, 2018 and 2017 and the related statements of activities and of cash flows for the years then ended, the related statement of functional expenses for the year ended December 31, 2018, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform our audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Houston Zoo, Inc. as of December 31, 2018 and 2017 and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Adoption of New Accounting Standard and Change in Method of Applying Accounting Principle

As discussed in Note 2 to the financial statements, Houston Zoo, Inc. adopted the amendments of Accounting Standards Update (ASU) 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*, and changed its method of accounting for membership revenue as of and for the year ended December 31, 2018. These changes have been applied on a retrospective basis to the financial statements as of and for the year ended December 31, 2017, except that certain information has been omitted as permitted by the ASU. Our opinion is not modified with respect to this matter.

Blazek & Vetterling

May 20, 2019

Houston Zoo, Inc.

Statements of Financial Position as of December 31, 2018 and 2017

	<u>2018</u>	<u>2017</u>
ASSETS		
Cash	\$ 4,283,929	\$ 838,842
Concessionaire and other receivables	627,463	533,973
Accounts receivable from the City of Houston		2,500,000
Prepaid expenses and other assets	1,085,341	916,604
Operating contributions receivable, net (Note 5)	2,765,548	1,553,925
Restricted or designated cash	28,662,067	23,186,352
Contributions receivable for capital acquisitions, net (Note 5)	51,826,884	16,671,756
Investments (Notes 6 and 7)	19,452,380	20,132,006
Property and equipment, net (Note 8)	117,642,177	107,103,758
Animal and horticultural collections (Note 1)		
	<hr/>	<hr/>
TOTAL ASSETS	<u>\$ 226,345,789</u>	<u>\$ 173,437,216</u>
LIABILITIES AND NET ASSETS		
Liabilities:		
Accounts payable	\$ 2,605,032	\$ 2,205,558
Construction payables	1,638,960	838,525
Accrued salaries and benefit costs	1,328,780	1,255,544
Funds held for others	70,483	166,125
Deferred revenue:		
Membership fees (Note 2)	3,281,255	3,330,535
Other	470,625	648,554
	<hr/>	<hr/>
Total liabilities	<u>9,395,135</u>	<u>8,444,841</u>
Commitments (Note 13)		
Net assets:		
Without donor restrictions (Note 9)	144,066,349	131,758,200
With donor restrictions (Notes 10 and 11)	72,884,305	33,234,175
	<hr/>	<hr/>
Total net assets	<u>216,950,654</u>	<u>164,992,375</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 226,345,789</u>	<u>\$ 173,437,216</u>

See accompanying notes to financial statements.

Houston Zoo, Inc.

Statement of Activities for the year ended December 31, 2018

	WITHOUT DONOR RESTRICTIONS	WITH DONOR RESTRICTIONS	TOTAL
REVENUE:			
Contributions	\$ 3,955,381	\$ 53,167,631	\$ 57,123,012
Admission fees	13,659,788		13,659,788
City management fee (Note 4)	9,973,836		9,973,836
Guest program fees	7,488,466		7,488,466
Membership fees	7,221,576		7,221,576
Concession contract income	3,539,267		3,539,267
Special events	1,878,219		1,878,219
Cost of benefits provided to donors	(513,367)		(513,367)
Educational program fees	1,362,069		1,362,069
Net investment return	(258,307)	(412,560)	(670,867)
Other income	657,178		657,178
	<u>48,964,106</u>	<u>52,755,071</u>	<u>101,719,177</u>
Total revenue			
Net assets released from restrictions:			
Capital expenditures	10,006,119	(10,006,119)	
Program expenses	2,351,169	(2,351,169)	
Expiration of time restrictions	747,653	(747,653)	
	<u>62,069,047</u>	<u>39,650,130</u>	<u>101,719,177</u>
Total			
EXPENSES:			
Zoo programs:			
Exhibition facility operations	19,176,662		19,176,662
Depreciation	8,429,292		8,429,292
Education and conservation programs	6,163,732		6,163,732
Admissions and guest relations	4,185,475		4,185,475
Guest program events	2,847,626		2,847,626
	<u>40,802,787</u>		<u>40,802,787</u>
Total zoo programs			
Advertising and marketing costs	2,446,129		2,446,129
Membership development	1,703,899		1,703,899
Management and general	2,755,245		2,755,245
Fundraising	2,052,838		2,052,838
	<u>49,760,898</u>		<u>49,760,898</u>
Total expenses			
CHANGES IN NET ASSETS	12,308,149	39,650,130	51,958,279
Net assets, beginning of year	<u>131,758,200</u>	<u>33,234,175</u>	<u>164,992,375</u>
Net assets, end of year	<u>\$ 144,066,349</u>	<u>\$ 72,884,305</u>	<u>\$ 216,950,654</u>

See accompanying notes to financial statements.

Houston Zoo, Inc.

Statement of Activities for the year ended December 31, 2017

	WITHOUT DONOR RESTRICTIONS	WITH DONOR RESTRICTIONS	TOTAL
REVENUE:			
Contributions	\$ 3,511,345	\$ 21,743,280	\$ 25,254,625
Admission fees	14,600,067		14,600,067
City management fee (Note 4)	9,837,416		9,837,416
Guest program fees	7,484,121		7,484,121
Membership fees (Note 2)	7,191,796		7,191,796
Concession contract income	3,735,310		3,735,310
Special events	932,901	690,508	1,623,409
Cost of benefits provided to donors	(227,288)	(149,126)	(376,414)
Educational program fees	1,052,942		1,052,942
Net investment return	865,147	856,648	1,721,795
Other income	<u>502,802</u>		<u>502,802</u>
Total revenue	49,486,559	23,141,310	72,627,869
Net assets released from restrictions:			
Capital expenditures	3,201,329	(3,201,329)	
Program expenses	1,533,269	(1,533,269)	
Expiration of time restrictions	<u>742,591</u>	<u>(742,591)</u>	
Total	<u>54,963,748</u>	<u>17,664,121</u>	<u>72,627,869</u>
EXPENSES:			
Zoo programs:			
Exhibition facility operations	19,612,561		19,612,561
Depreciation	8,320,648		8,320,648
Education and conservation programs	5,334,249		5,334,249
Admissions and guest relations	4,146,877		4,146,877
Guest program events	<u>2,645,255</u>		<u>2,645,255</u>
Total zoo programs	40,059,590		40,059,590
Advertising and marketing costs	2,354,236		2,354,236
Membership development	1,748,953		1,748,953
Management and general	2,592,384		2,592,384
Fundraising	<u>2,041,025</u>		<u>2,041,025</u>
Total expenses	<u>48,796,188</u>		<u>48,796,188</u>
CHANGES IN NET ASSETS	6,167,560	17,664,121	23,831,681
Net assets, beginning of year (Note 2)	<u>125,590,640</u>	<u>15,570,054</u>	<u>141,160,694</u>
Net assets, end of year	<u>\$ 131,758,200</u>	<u>\$ 33,234,175</u>	<u>\$ 164,992,375</u>

See accompanying notes to financial statements.

Houston Zoo, Inc.

Statements of Cash Flows for the years ended December 31, 2018 and 2017

	<u>2018</u>	<u>2017</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Changes in net assets	\$ 51,958,279	\$ 23,831,681
Adjustments to reconcile changes in net assets to net cash provided by operating activities:		
Depreciation	8,429,292	8,320,648
Net realized and unrealized (gain) loss on investments	1,112,178	(1,278,583)
Contributions restricted for capital acquisitions	(51,675,436)	(20,422,458)
Contributions for permanent endowment funds	(2,000)	(4,000)
Changes in operating assets and liabilities:		
Concessionaire and other receivables	(93,490)	(13,504)
Accounts receivable from the City of Houston	2,500,000	(2,500,000)
Prepaid expenses and other assets	(168,737)	136,104
Operating contributions receivable	(1,211,623)	723,041
Accounts payable	399,474	230,276
Accrued salaries and benefit costs	73,236	66,119
Funds held for others	(95,642)	(717,764)
Deferred revenue	<u>(227,209)</u>	<u>328,095</u>
Net cash provided by operating activities	<u>10,998,322</u>	<u>8,699,655</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(18,167,276)	(14,324,976)
Purchases of investments	(15,271,709)	(11,810,107)
Proceeds from sale of investments	14,966,892	10,802,215
Net change in money market mutual funds held as investments	<u>(127,735)</u>	<u>550,886</u>
Net cash used by investing activities	<u>(18,599,828)</u>	<u>(14,781,982)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from contributions restricted for capital acquisitions	16,520,308	7,635,550
Proceeds from contributions received for permanent endowment funds	<u>2,000</u>	<u>4,000</u>
Net cash provided by financing activities	<u>16,522,308</u>	<u>7,639,550</u>
NET CHANGE IN CASH	8,920,802	1,557,223
Cash, beginning of year	<u>24,025,194</u>	<u>22,467,971</u>
Cash, end of year	<u>\$ 32,945,996</u>	<u>\$ 24,025,194</u>
<i>Reconciliation of cash:</i>		
Restricted or designated cash	\$ 28,662,067	\$ 23,186,352
Other cash	<u>4,283,929</u>	<u>838,842</u>
Total cash	<u>\$ 32,945,996</u>	<u>\$ 24,025,194</u>
<i>Supplemental disclosure of cash flow information:</i>		
Contributions of marketable securities	\$4,225,096	\$1,331,050

See accompanying notes to financial statements.

Houston Zoo, Inc.

Statement of Functional Expenses for the year ended December 31, 2018

	ZOO PROGRAMS	ADVERTISING AND MARKETING COSTS	MEMBERSHIP DEVELOPMENT	MANAGEMENT AND GENERAL	FUNDRAISING	TOTAL
Salaries, related taxes, and benefits	\$ 21,194,298	\$ 723,272	\$ 944,108	\$ 1,708,543	\$ 1,481,862	\$ 26,052,083
Depreciation	8,429,292					8,429,292
Professional fees and contract labor	2,333,328	121,132	155,290	559,184	225,483	3,394,417
Supplies, materials and equipment	3,155,275	28,672	15,118	111,382	35,726	3,346,173
Conservation grants made	2,950,497					2,950,497
Advertising and promotion	41,807	1,403,337	4,259	17,458	4,727	1,471,588
Occupancy	852,060	3,552	7,104	28,416	3,552	894,684
Printing and postage	146,846	131,306	352,591	6,539	60,122	697,404
Insurance	567,132	10,136	21,194	25,802	12,901	637,165
Credit card fees	424,451		164,896	49	43,540	632,936
Information technology	100,064	11,333	20,339	271,951	54,554	458,241
Conferences, conventions, and meetings	286,755	746	11,758	1,378	104,816	405,453
Travel	<u>320,982</u>	<u>12,643</u>	<u>7,242</u>	<u>24,543</u>	<u>25,555</u>	<u>390,965</u>
Total expenses	<u>\$ 40,802,787</u>	<u>\$ 2,446,129</u>	<u>\$ 1,703,899</u>	<u>\$ 2,755,245</u>	<u>\$ 2,052,838</u>	49,760,898
Cost of benefits provided to donors						<u>513,367</u>
Total						<u>\$ 50,274,265</u>

See accompanying notes to financial statements.

Houston Zoo, Inc.

Notes to Financial Statements for the years ended December 31, 2018 and 2017

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization – Ninety-seven years ago, the City of Houston (the City) created a zoo program and facility to benefit the citizens of Houston and surrounding areas. In 2002, the zoo was privatized by order of the City and operates as Houston Zoo, Inc. (the Houston Zoo).

The Houston Zoo is a conservation, education, and recreation organization dedicated to the reproduction, protection, and exhibition of animals in their habitats. The Houston Zoo provides a fun, unique and inspirational experience fostering appreciation, knowledge and care for the natural world.

Federal income tax status – The Houston Zoo is exempt from federal income tax under §501(c)(3) of the Internal Revenue Code and is classified as a public charity under §509(a)(2).

Cash – Bank deposits exceed the federally insured limit per depositor per institution.

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

Allowance for uncollectible accounts – An allowance for accounts receivable or contributions receivable is provided when it is believed accounts may not be collected in full. The Houston Zoo's policy is to write off receivables against the allowance when management determines the receivable will not be collected. The amount of bad debt expense or loss on valuation of contributions receivable recognized each period and the resulting adequacy of the allowance at the end of each period are determined using a combination of historical loss experience and analysis of individual balances each period. Management's estimates regarding the collectability of the balances could change in the near term resulting in a change in the carrying value of these receivables.

Investments are reported at fair value. Net investment return consists of interest and dividends, realized and unrealized gains and losses, net of external and direct internal investment expenses.

Property and equipment are reported at cost, if purchased, or at fair value at the date of gift, if donated. The Houston Zoo capitalizes property and equipment that has a cost or fair value of \$5,000 or greater and an estimated useful life of more than one year. The Houston Zoo recognizes depreciation using the straight-line method over the estimated useful lives of the assets, ranging from 3 to 30 years.

Animal and horticultural collections – In accordance with industry practice, the Houston Zoo does not capitalize animal and horticultural collections; acquisitions are reported as expenditures in the period of acquisition. The Houston Zoo is responsible for the health and welfare of its animal and horticultural collections. The Houston Zoo maintains records of its collections and any exchanges with other organizations. Under the direction of the Board of Directors, the President, and the curatorial staff, collections continue to be cared for, used, and expanded. In 2018 and 2017, the Houston Zoo expended approximately \$32,000 and \$25,000, respectively, to expand its collections.

In an ongoing commitment to enhance worldwide reproduction and conservation of animals, the Houston Zoo exchanges animals with other organizations. Consistent with industry practice, the Houston Zoo does

not record any liability for such exchange arrangements as generally these arrangements are without monetary consideration.

Funds held for others – The Houston Zoo holds funds for several organizations. Funds held for others are included in the Houston Zoo’s cash and as a liability of the Houston Zoo.

Net asset classification – Net assets, revenue, gains, and losses are classified based on the existence or absence of donor-imposed restrictions, as follows:

- *Net assets without donor restrictions* are not subject to donor-imposed restrictions even though their use may be limited in other respects such as by contract or board designation.
- *Net assets with donor restrictions* are subject to donor-imposed restrictions. Restrictions may be temporary in nature, such as those that will be met by the passage of time or use for a purpose specified by the donor, or may be perpetual in nature, where the donor stipulates that resources be maintained in perpetuity. Net assets are released from restrictions when the stipulated time has elapsed, or purpose has been fulfilled, or both. Contributions of long-lived assets and of assets restricted for acquisition of long-lived assets are released when those assets are placed in service. Donor-restricted endowment earnings are released when those earnings are appropriated in accordance with spending policies and are used for the stipulated purpose.

Contributions are recognized at fair value when an unconditional commitment is received from the donor. Conditional contributions are recognized in the same manner when the conditions are substantially met.

Donated materials, use of facilities and services – Donated materials and use of facilities are recognized at fair value as unrestricted contributions when an unconditional commitment is received from the donor. The related expense is recognized as the item is used. Contributions of services are recognized when services received (a) create or enhance nonfinancial assets or (b) require specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not provided by donation.

During 2018, approximately 1,300 volunteers contributed approximately 65,000 hours in connection with programs. During 2017, approximately 1,200 volunteers contributed approximately 59,000 hours in connection with programs. No amount has been recorded in the financial statements because the services did not meet the criteria for recognition under generally accepted accounting principles.

Special events revenue is recognized when the event occurs. Amounts received in advance of the event represent conditional contributions and are reported in the statement of financial position as deferred revenue. Direct donor benefit costs represent the cost of goods and services provided to attendees of special events.

Membership fees are recognized ratably over the membership year. Membership fees collected in advance are reported as deferred revenue.

Fees for services – Revenue from admissions, concessions, educational program fees and guest program fees services such as food vendors and stroller rentals are recognized when the related services are provided. Fees for services collected in advance are reported as deferred revenue until earned.

Grants made are recognized as expense at fair value when the Houston Zoo approves an unconditional commitment to a grant recipient. Commitments made but not yet funded are recorded as grants payable and are discounted, if material, to estimate the present value of future cash flows.

Advertising and marketing costs are expensed as incurred.

Functional allocation of expenses – Expenses are reported by their functional classification as program services or supporting activities. Program services are the direct conduct or supervision of activities that fulfill the purposes for which the organization exists. Fundraising activities include the solicitation of contributions of money, securities, materials, facilities, other assets, and time. Membership development activities include soliciting for prospective members and membership dues, membership relations, and similar activities. Management and general activities are not directly identifiable with specific program or other supporting activities. Expenses that are attributable to one or more program or supporting activities are allocated among the activities benefitted. Salaries and related costs are allocated on the basis of estimated time and effort expended. Training, postage and delivery, telephone, fuel, uniforms and insurance is allocated based on employee headcount of each department. Information technology costs are allocated based on estimates of time and costs of specific technology utilized.

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

Recent financial accounting pronouncements – In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers*, which replaces most existing revenue recognition guidance for exchange transactions not specifically covered by other guidance. This ASU does not apply to non-exchange transactions such as contributions. The core principle of the new guidance is that an entity should recognize revenue in an amount that reflects the consideration to which it expects to be entitled in exchange for transferred goods or services and establishes a 5-step process to determine when performance obligations are satisfied and revenue is recognized. The ASU is effective for the Houston Zoo for fiscal year 2019 and must be applied retrospectively. Adoption of this ASU will impact the presentation and disclosures of the financial statements.

In June 2018, the FASB issued ASU 2018-08, *Not-for-Profit Entities (Topic 958): Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. The amendments in this ASU clarify and improve current guidance about whether a transfer of assets (or the reduction, settlement, or cancellation of liabilities) is a contribution or an exchange transaction and provide additional guidance on determining whether a contribution is conditional or unconditional. This ASU could impact the timing of revenue recognition and the financial statement disclosures related to such transactions. The Houston Zoo will adopt this ASU in fiscal year 2019. The amendments should be applied on a modified prospective basis, but retrospective application also is permitted. Management anticipates that adoption may impact the classification of certain transactions and disclosures.

NOTE 2 – ADOPTION OF ACCOUNTING STANDARDS UPDATE 2016-14 AND CHANGES IN METHOD OF APPLYING ACCOUNTING PRINCIPLE

The Houston Zoo adopted the amendments of ASU 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*, as of and for the year ended December 31, 2018. These amendments have been applied on a retrospective basis to the financial statements for the year ended December 31, 2017, except that information regarding liquidity and availability of resources and presentation of expenses by both nature and function has been omitted as permitted by the ASU. Adoption of this ASU resulted in reclassification of previously reported activities and net assets to conform to the 2018 presentation.

In connection with adoption of ASU 2016-14 during 2018, and in preparation for adoption of ASU 2014-09, *Revenue from Contracts with Customers*, in 2019, the Houston Zoo evaluated historical data comparing the value of benefits provided to members relative to the amount paid by members for the various membership levels. On average, the fair value of the benefits provided to members equaled or exceeded the membership paid indicating that there is no substantial contribution element to memberships. During 2018, the Houston Zoo changed its methodology to recognize memberships as exchange transactions ratably over the membership terms rather than as contributions. The 2017 financial statements were restated to conform with the new methodology.

In connection with this restatement, the following changes were made to the financial statements as of and for the year ended December 31, 2017:

	2017 PREVIOUSLY REPORTED	2017 AS RESTATED	INCREASE (DECREASE)
Deferred membership revenue		\$3,281,255	\$3,281,255
Net assets, beginning of year	\$144,447,154	\$141,160,694	\$(3,286,460)
Net assets, end of year	\$168,322,910	\$164,992,375	\$(3,330,535)
Membership fees	\$7,235,871	\$7,191,796	\$(44,075)
Changes in net assets	\$23,875,756	\$23,831,681	\$(44,075)

NOTE 3 – LIQUIDITY AND AVAILABILITY OF RESOURCES

Financial assets available for general expenditure, that is, without donor or other restrictions limiting their use, within one year of December 31, 2018 comprise the following:

Financial assets at December 31, 2018:

Cash	\$ 4,283,929
Concessionaire and other receivables	627,463
Operating contributions receivable	2,765,548
Restricted or designated cash	28,662,067
Contributions receivable for capital acquisitions, net	51,826,884
Investments	<u>19,452,380</u>
Total financial assets	107,618,271
Less financial assets not available for general expenditure:	
Funds held for others	(70,483)
Donor-restricted for capital acquisitions	(53,764,382)
Board-designated reserves	(31,023,228)
Board-designated endowment funds	(5,837,210)
Donor-restricted endowment funds	(5,872,212)
Donor-restricted not expected to be used within one year	<u>(2,532,835)</u>
Total financial assets available for general expenditure	<u>\$ 8,517,921</u>

For purposes of analyzing resources available to meet general expenditures over a 12-month period, the Houston Zoo considers all expenditures related to its ongoing activities of exhibition facility operations, education and conservation programs, admissions and guest relations and guest program events, as well as the conduct of services undertaken to support these activities other than capital expenditures, to be general expenditures.

As part of the Houston Zoo’s liquidity management, financial assets have been structured to be available as its general expenditures, liabilities, and other obligations become due by maintaining a significant portion of its assets in cash. Financial assets available for general expenditures of \$8,517,921 will be used for ongoing maintenance of the Houston Zoo and new exhibits and also includes approximately \$2.6 million of restricted contributions received for restricted projects scheduled for completion in fiscal year 2019.

The Houston Zoo’s Board of Directors has designated a portion of its unrestricted resources for endowment and other purposes. These board-designated funds are invested for long-term appreciation and current income but remain available to be spent at the Board of Directors’ discretion.

NOTE 4 – ZOO OPERATIONS AGREEMENT

In 2002, the City entered a 50-year lease for the land, buildings and improvements of the zoo premises with the Houston Zoo Development Corporation (HZDC). HZDC is a Texas local government corporation created by the City for the sole purpose of leasing the zoo premises. Concurrently, HZDC entered into a 50-year operating agreement with the Houston Zoo to operate, maintain, manage, and develop the zoo premises. Under the operating agreement with HZDC, the Houston Zoo receives an annual management fee that will be increased each year based on the Consumer Price Index. The management fee is subject to annual appropriation and budget approval by the City. The operating agreement can be terminated by the Houston Zoo if the annual appropriation is not approved by the City. The Houston Zoo recognized a management fee from the City of \$9,973,836 in 2018 and \$9,837,416 in 2017. At December 31, 2017, \$2.5 million was due from the City related to the operating agreement.

NOTE 5 – CONTRIBUTIONS RECEIVABLE

Contributions receivable are as follows:

	<u>2018</u>	<u>2017</u>
Contributions receivable	\$ 62,056,283	\$ 18,528,356
Discount to net present value at 0.36% to 2.46%	<u>(7,463,851)</u>	<u>(302,675)</u>
Contributions receivable, net	54,592,432	18,225,681
Operating contributions receivable, net	<u>(2,765,548)</u>	<u>(1,553,925)</u>
Contributions receivable for capital acquisitions, net	<u>\$ 51,826,884</u>	<u>\$ 16,671,756</u>

Contributions receivable at December 31, 2018 are expected to be collected as follows:

Receivable in less than one year	\$ 6,825,622
Receivable in one to five years	15,131,403
Receivable in more than five years	<u>40,099,258</u>
Total pledges receivable	<u>\$ 62,056,283</u>

At December 31, 2018, approximately 80% of contributions receivable is due from one foundation. At December 31, 2017, approximately 41% of contributions receivable were due from two donors. During 2018, contributions from one foundation comprised 88% of total contributions and is for the *Centennial* capital campaign.

NOTE 6 – INVESTMENTS

Investments consist of the following:

	<u>2018</u>	<u>2017</u>
Equity mutual funds	\$ 7,145,629	\$ 8,268,533
Corporate bonds and notes	4,694,637	5,019,437
Fixed-income mutual funds	2,952,936	2,710,980
U. S. Treasury notes	2,137,007	1,729,366
Money market mutual funds	1,785,651	1,657,916
Exchange-traded funds	<u>736,520</u>	<u>745,774</u>
Total investments	<u>\$ 19,452,380</u>	<u>\$ 20,132,006</u>

Investments at December 31, 2018 and 2017 are held for the endowment and board-designated operating reserves.

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

NOTE 7 – FAIR VALUE MEASUREMENTS

Generally accepted accounting principles require that certain assets and liabilities be reported at fair value and establish a hierarchy that prioritizes inputs used to measure fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The three levels of the fair value hierarchy are as follows:

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

Assets measured at fair value at December 31, 2018 are as follows:

	<u>LEVEL 1</u>	<u>LEVEL 2</u>	<u>LEVEL 3</u>	<u>TOTAL</u>
Investments:				
Equity mutual funds:				
Developed international	\$ 2,655,857			\$ 2,655,857
Domestic large-cap growth	2,179,705			2,179,705
Domestic large-cap value	1,693,157			1,693,157
Commodity	259,572			259,572
Domestic small-cap	197,432			197,432
Real estate	159,906			159,906
Corporate bonds and notes:				
BAA-rated		\$ 2,445,139		2,445,139
A-rated		1,746,101		1,746,101
Other ratings		503,397		503,397
Fixed-income mutual funds:				
High yield bond	801,176			801,176
Inflation protected	741,049			741,049
Corporate bond	524,536			524,536
Government bond	465,621			465,621
Asset-backed securities	420,554			420,554
U. S. Treasury notes	2,137,007			2,137,007
Money market mutual funds	1,785,651			1,785,651
Exchange-traded funds	<u>736,520</u>			<u>736,520</u>
Total assets measured at fair value	<u>\$ 14,757,743</u>	<u>\$ 4,694,637</u>	<u>\$ 0</u>	<u>\$ 19,452,380</u>

Assets measured at fair value at December 31, 2017 are as follows:

	<u>LEVEL 1</u>	<u>LEVEL 2</u>	<u>LEVEL 3</u>	<u>TOTAL</u>
Investments:				
Equity mutual funds:				
Developed international	\$ 3,252,602			\$ 3,252,602
Domestic large-cap growth	2,278,539			2,278,539
Domestic large-cap value	1,747,958			1,747,958
Commodity	659,212			659,212
Domestic small-cap	239,255			239,255
Real estate	90,967			90,967
Corporate bonds and notes:				
BAA-rated		\$ 2,065,450		2,065,450
A-rated		2,236,439		2,236,439
Other ratings		717,548		717,548
Fixed-income mutual funds:				
High yield bond	777,429			777,429
Inflation protected	664,650			664,650
Corporate bond	483,810			483,810
Government bond	415,063			415,063
Asset-backed securities	370,028			370,028
U. S. Treasury notes	1,729,366			1,729,366
Money market mutual funds	1,657,916			1,657,916
Exchange-traded funds	<u>745,774</u>			<u>745,774</u>
Total assets measured at fair value	<u>\$ 15,112,569</u>	<u>\$ 5,019,437</u>	<u>\$ 0</u>	<u>\$ 20,132,006</u>

Valuation methods used for assets measured at fair value are as follows:

- *Mutual funds* are valued at the net asset value of shares held at year end.
- *Corporate bonds and notes* are valued using prices obtained from independent quotation bureaus that use computerized valuation formulas to calculate fair values.
- *U. S. Treasury notes* are valued using prices obtained from active market maker and inter-dealer brokers on a daily basis.
- *Exchange-traded funds* are valued at the closing price reported on the active market on which the individual securities are traded.

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 Houston Zoo 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 8 – PROPERTY AND EQUIPMENT

Property and equipment consist of the following:

	<u>2018</u>	<u>2017</u>
Leasehold improvements	\$ 150,207,958	\$ 138,272,246
Furniture, fixtures and equipment	13,797,765	12,913,073
Construction in progress	<u>11,381,040</u>	<u>5,233,733</u>
Total property and equipment, at cost	175,386,763	156,419,052
Accumulated depreciation	<u>(57,744,586)</u>	<u>(49,315,294)</u>
Property and equipment, net	<u>\$ 117,642,177</u>	<u>\$ 107,103,758</u>

NOTE 9 – NET ASSETS WITHOUT DONOR RESTRICTIONS

Net assets without donor restrictions are comprised of the following:

	<u>2018</u>	<u>2017</u>
Property and equipment, net	\$ 105,387,819	\$ 103,581,866
Zoo operations	1,818,092	2,496,069
Board-designated for strategic operating and capital initiatives (2017-2022)	22,936,466	11,520,597
Board-designated operating reserve	8,086,762	7,977,199
Board-designated endowment funds:		
Maintenance	3,890,733	4,160,892
General	<u>1,946,477</u>	<u>2,021,577</u>
Total net assets without donor restrictions	<u>\$ 144,066,349</u>	<u>\$ 131,758,200</u>

The Houston Zoo has a policy regarding establishing board-designated endowments to fund maintenance reserves in accordance with the terms of the contract with HZDC and the City. For any exhibits that include \$500,000 or more in construction costs, the Houston Zoo must establish a maintenance reserve equal to 5% of the construction cost. In addition, the Board of Directors established a policy for the general endowment fund, whereby any bequest received that is not donor restricted is to be added to the general endowment fund unless otherwise approved by the Houston Zoo's Finance Committee.

The Board of Directors does not have a specific policy in regards to establishing other reserves. However, the Board of Directors designates excess cash flows for reserves or specific projects as deemed prudent. Use of board-designated reserves must be approved by the Board of Directors.

NOTE 10 – NET ASSETS WITH DONOR RESTRICTIONS

Net assets with donor restrictions are restricted as follows:

	<u>2018</u>	<u>2017</u>
Subject to expenditure for specified purpose:		
Capital acquisitions	\$ 61,841,775	\$ 20,422,458
Conservation	3,571,900	5,346,906
John P. McGovern Children’s Zoo	523,810	273,810
Other	<u>80,261</u>	<u>149,029</u>
Total subject to expenditure for specified purpose	<u>66,017,746</u>	<u>26,192,203</u>
Subject to passage of time:		
Contributions receivable that are not restricted by donors, but which are unavailable for expenditures until due	<u>994,347</u>	<u>751,000</u>
Total subject to passage of time	<u>994,347</u>	<u>751,000</u>
Endowments:		
Subject to spending policy and appropriation:		
Jane Block Endowment for the Children’s Zoo	2,966,115	3,172,071
Conservation programs	1,073,776	1,154,751
Clark and Gordon Memorial special event endowment	870,612	934,664
Zoo Friends education exhibits	318,226	341,968
Martel Lecture Series	159,506	170,582
Fred Maier Beautification Fund	128,216	137,119
Morris Docent Education Award	85,488	91,424
Alban Heiser Conservation Award	55,807	60,751
Carter Education Internship	41,545	45,713
Other endowments	<u>172,921</u>	<u>181,929</u>
Total endowments	<u>5,872,212</u>	<u>6,290,972</u>
Total net assets with donor restrictions	<u>\$ 72,884,305</u>	<u>\$ 33,234,175</u>

NOTE 11 – ENDOWMENT FUNDS

The Houston Zoo’s endowment (the Endowment) was established for the purpose of supporting operating needs and program services that are consistent with the Houston Zoo’s mission, and to provide growth and expansion of programs and/or creation of new programs. The Endowment includes both donor-restricted endowment funds and funds designated by the Board of Directors (the Board) of the Houston Zoo to function as endowments.

Donor-restricted endowment funds are subject to the Texas Uniform Prudent Management of Institutional Funds Act (TUPMIFA). The Board has interpreted TUPMIFA as allowing the Houston Zoo to appropriate for expenditure or accumulate as much of an endowment fund as determines is prudent for the uses, benefits, purposes, and duration for which the endowment fund was established, subject to explicit donor stipulations.

Donor-restricted endowment net assets are classified as *net assets with donor restrictions* until appropriated in accordance with spending policies and used for the stipulated purpose, if any. The Houston Zoo classifies contributions to an endowment plus any donor-stipulated accumulations as *net assets with donor restrictions required to be maintained in perpetuity*. The unappropriated investment earnings on donor-restricted endowments are classified as *net assets with donor restrictions accumulated net investment return*. The Board has interpreted TUPMIFA as not precluding the Houston Zoo from spending below the amount required to be maintained in perpetuity subject to prudent standards. An endowment fund is *underwater* if the fair value of the fund's investments falls below the amount required to be maintained in perpetuity because of declines in the fair value of investments and/or continued appropriation and spending in accordance prudent measures.

Board-designated endowment funds are classified as *net assets without donor restrictions* and represents the funds the Board has internally designated to be invested to provide support for the Houston Zoo generally for a long-term but not necessarily a specified period of time. The Board retains discretion over the use of these funds.

Investment Objectives

The Houston Zoo has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to enhance its real (inflation-adjusted) value over time. Under this policy, as approved by the Board of Directors, the endowment assets are invested in a manner that is intended to produce results that are the greater of the Consumer Price Index plus 4% to 5% or a custom index, while assuming a moderate level of investment risk. The Houston Zoo expects its endowment funds, over time, to provide a real return of approximately 4% to 5% over the long term. Actual returns in any given year may vary from this amount.

Endowment funds are maintained in investment accounts which are managed by independent financial advisors that follow guidance provided in an investment policy approved by the Board of Directors. To satisfy its long-term rate-of-return objectives, the Houston Zoo relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Houston Zoo 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 Houston Zoo has a policy of appropriating for distribution each year up to 3% of its endowment fund's average fair value over the prior 12 quarters through the calendar year end preceding the fiscal year in which the distribution is planned, but may not exceed the cumulative actual earnings and appreciation of the funds. In establishing this policy, the Houston Zoo considered the long-term expected return on its endowment. The Houston Zoo's objective is to enhance the real (inflation-adjusted) value over time of the endowment assets held in perpetuity or for a specified term 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 Houston Zoo to retain as a fund of perpetual duration. In accordance with generally accepted accounting principles, deficiencies of this nature are reported in *net assets with donor restrictions*, if any.

Changes in endowment net assets are as follows:

	BOARD- DESIGNATED ENDOWMENT	WITH DONOR RESTRICTIONS		TOTAL
		ACCUMULATED NET INVESTMENT RETURN	REQUIRED TO BE MAINTAINED IN PERPETUITY	
Endowment net assets, December 31, 2016	\$ 5,395,431	\$ 1,912,320	\$ 3,518,004	\$ 10,825,755
Contributions	5,000		4,000	9,000
Net investment return	<u>782,038</u>	<u>852,553</u>	<u>4,095</u>	<u>1,638,686</u>
Endowment net assets, December 31, 2017	<u>6,182,469</u>	<u>2,764,873</u>	<u>3,526,099</u>	<u>12,473,441</u>
Contributions	31,368		2,000	33,368
Net investment return	(376,627)	(410,588)	(1,972)	(789,187)
Distributions	<u> </u>	<u>(8,200)</u>	<u> </u>	<u>(8,200)</u>
Endowment net assets, December 31, 2018	<u>\$ 5,837,210</u>	<u>\$ 2,346,085</u>	<u>\$ 3,526,127</u>	<u>\$ 11,709,422</u>

Endowment net asset composition as of December 31, 2018:

	WITHOUT DONOR RESTRICTIONS	WITH DONOR RESTRICTIONS	TOTAL
Donor-restricted endowment funds:			
Original donor-restricted gift and amounts required to be maintained in perpetuity		\$ 3,526,127	\$ 3,526,127
Accumulated net investment return		2,346,085	2,346,085
Board-designated endowment funds	<u>\$ 5,837,210</u>	<u> </u>	<u>5,837,210</u>
Endowment net assets	<u>\$ 5,837,210</u>	<u>\$ 5,872,212</u>	<u>\$ 11,709,422</u>

Endowment net asset composition as of December 31, 2017:

	WITHOUT DONOR RESTRICTIONS	WITH DONOR RESTRICTIONS	TOTAL
Donor-restricted endowment funds:			
Original donor-restricted gift and amounts required to be maintained in perpetuity		\$ 3,526,099	\$ 3,526,099
Accumulated net investment return		2,764,873	2,764,873
Board-designated endowment funds	<u>\$ 6,182,469</u>	<u> </u>	<u>6,182,469</u>
Endowment net assets	<u>\$ 6,182,469</u>	<u>\$ 6,290,972</u>	<u>\$ 12,473,441</u>

NOTE 12 – RETIREMENT PLAN

The Houston Zoo retirement savings plan is qualified under §401(k) of the Internal Revenue Code. The plan allows eligible employees to contribute a portion of their earnings each plan year subject to certain Internal Revenue Service limitations and to defer federal income taxes on the contributions. The Houston Zoo matches 100% of the first 3% of employee contributions and matches 50% of contributions from 3% to 5%. The employee is 100% immediately vested in the employer's contributions. The Houston Zoo contributed approximately \$672,000 and \$625,000 to the plan during 2018 and 2017, respectively.

NOTE 13 – COMMITMENTS

As of December 31, 2018, the Houston Zoo has entered into various construction commitments totaling approximately \$24 million. The unrecognized balance of these commitments at December 31, 2018 was approximately \$6.4 million.

NOTE 14 – SUBSEQUENT EVENTS

Management has evaluated subsequent events through May 20, 2019, which is the date that the financial statements were available for issuance. As a result of this evaluation, no events were identified that are required to be disclosed or would have a material impact on reported net assets or changes in net assets.
