# FAMILY HOUSE, INC.

*(A California Nonprofit Public Benefit Corporation)*

**FINANCIAL STATEMENTS**

**AND**

**INDEPENDENT AUDITOR'S REPORT**

**YEARS ENDED DECEMBER 31, 2012 AND 2011**

FAMILY HOUSE, INC.

*(A California Nonprofit Public Benefit Corporation)*

FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

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LINDQUIST
VON HUSEN
& JOYCE LLP



Board of Directors
Family House, Inc.
San Francisco, California

**INDEPENDENT AUDITOR'S REPORT**

*Report on the Financial Statements*

We have audited the accompanying financial statements of Family House, Inc. a California nonprofit public benefit corporation, which comprise the statements of financial position as of December 31, 2012 and 2011, and the related statements of activities, functional expenses, and cash flows for the years then ended, and the related notes to the financial statements.

*Management's Responsibility for the Financial Statements*

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

*Auditor's Responsibility*

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the 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 auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the 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.



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*Opinion*

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Family House, Inc. as of December 31, 2012 and 2011, 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.

Lindquist, von Husen and Joyce LLP

July 18, 2013

FAMILY HOUSE, INC.

*(A California Nonprofit Public Benefit Corporation)*

STATEMENTS OF FINANCIAL POSITION

DECEMBER 31, 2012 AND 2011

| | 2012 | 2011 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash | $ 768,048 | $ 695,462 |
| Contributions receivable – net: | | |
| Capital campaign – current portion (Note 7) | 3,362,612 | 639,183 |
| Other – unrestricted | 50,000 | 25,000 |
| Prepaid expenses | 3,709 | 4,437 |
| Total current assets | 4,184,369 | 1,364,082 |
| Capital campaign receivable – net of current portion (Note 7) | 2,277,664 | 3,437,636 |
| Investments (Note 3) | 3,069,102 | 2,464,708 |
| Restricted cash: | | |
| Endowment (Note 3) | 6,282 | 23,213 |
| Development (Note7) | 1,560,379 | 903,146 |
| Property and equipment – net (Note 4) | 3,628,078 | 3,705,782 |
| Development in progress (Note 7) | 226,570 | 76,351 |
| Total assets | $ 14,952,444 | $ 11,974,918 |
| **LIABILITIES AND NET ASSETS** | | |
| Current liabilities: | | |
| Accounts payable and accrued expenses | $ 52,072 | $ 51,850 |
| Deferred revenue | 49,600 | 42,750 |
| Total current liabilities | 101,672 | 94,600 |
| Net assets: | | |
| Unrestricted | 6,401,424 | 5,819,908 |
| Temporarily restricted (Note 5) | 7,368,566 | 4,979,628 |
| Permanently restricted (Note 6) | 1,080,782 | 1,080,782 |
| Total net assets | 14,850,772 | 11,880,318 |
| Total liabilities and net assets | $ 14,952,444 | $ 11,974,918 |

*The accompanying notes are an integral part of these financial statements.*

FAMILY HOUSE, INC.

*(A California Nonprofit Public Benefit Corporation)*

STATEMENTS OF ACTIVITIES

YEARS ENDED DECEMBER 31, 2012 AND 2011

| | 2012 | | | |
|---|---|---|---|---|
| | *Unrestricted* | *Temporarily Restricted* | *Permanently Restricted* | *Total* |
| Support and revenue: | | | | |
| Contributions (Note 7) | $ 1,455,709 | $ 2,239,409 | $ - | $ 3,695,118 |
| Special events contributions | 541,143 | - | - | 541,143 |
| Special events revenue | 693,913 | - | - | 693,913 |
| Less: cost of special events | (427,214) | - | - | (427,214) |
| Interest and dividend income | 3,114 | - | - | 3,114 |
| Other income | 2,231 | - | - | 2,231 |
| Realized and unrealized gain on investments (Note 3) | 193,154 | 149,529 | - | 342,683 |
| Net assets released from restrictions | - | - | - | - |
| Total support and revenue | 2,462,050 | 2,388,938 | - | 4,850,988 |
| Expenses: | | | | |
| Program services | 1,052,813 | - | - | 1,052,813 |
| Management and general | 291,798 | - | - | 291,798 |
| Fundraising – general | 281,046 | - | - | 281,046 |
| Fundraising – capital campaign (Note7) | 254,877 | - | - | 254,877 |
| Total expenses | 1,880,534 | - | - | 1,880,534 |
| Change in net assets | 581,516 | 2,388,938 | - | 2,970,454 |
| Net assets, beginning of year | 5,819,908 | 4,979,628 | 1,080,782 | 11,880,318 |
| Net assets, end of year | $ 6,401,424 | $ 7,368,566 | $ 1,080,782 | $ 14,850,772 |

*The accompanying notes are an integral part of these financial statements.*

FAMILY HOUSE, INC.

*(A California Nonprofit Public Benefit Corporation)*

STATEMENTS OF ACTIVITIES

YEARS ENDED DECEMBER 31, 2012 AND 2011

| | 2011 | | | |
|---|---|---|---|---|
| | *Unrestricted* | *Temporarily Restricted* | *Permanently Restricted* | *Total* |
| Support and revenue: | | | | |
| Contributions (Note 7) | $ 1,257,563 | $ 4,895,279 | $ - | $ 6,152,842 |
| Special events contributions | 413,400 | - | - | 413,400 |
| Special events revenue | 605,552 | - | - | 605,552 |
| Less: cost of special events | (335,023) | - | - | (335,023) |
| Interest and dividend income | 2,217 | - | - | 2,217 |
| Realized and unrealized (loss) on investments (Note 3) | (31,782) | (31,561) | - | (63,343) |
| Net assets released from restrictions | 17,746 | (17,746) | - | - |
| Total support and revenue | 1,929,673 | 4,845,972 | - | 6,775,645 |
| Expenses: | | | | |
| Program services | 1,110,415 | - | - | 1,110,415 |
| Management and general | 220,513 | - | - | 220,513 |
| Fundraising – general | 234,957 | - | - | 234,957 |
| Fundraising – capital campaign (Note7) | 223,624 | - | - | 223,624 |
| Total expenses | 1,789,509 | - | - | 1,789,509 |
| Change in net assets | 140,164 | 4,845,972 | - | 4,986,136 |
| Net assets, beginning of year | 5,679,744 | 133,656 | 1,080,782 | 6,894,182 |
| Net assets, end of year | $ 5,819,908 | $ 4,979,628 | $ 1,080,782 | $ 11,880,318 |

*The accompanying notes are an integral part of these financial statements.*

FAMILY HOUSE, INC.

*(A California Nonprofit Public Benefit Corporation)*

STATEMENTS OF FUNCTIONAL EXPENSES

YEARS ENDED DECEMBER 31, 2012 AND 2011

| | 2012 | | | | | 2011 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | *Program Services* | *Management and General* | *Fundraising – General* | *Fundraising – Capital Campaign* | *Total* | *Program Services* | *Management and General* | *Fundraising – General* | *Fundraising – Capital Campaign* | *Total* |
| Payroll and related costs | $ 552,969 | $ 179,890 | $ 151,697 | $ 98,700 | $ 983,256 | $ 549,022 | $ 145,178 | $ 120,873 | $ 29,538 | $ 844,611 |
| Operating and maintenance | 175,356 | - | 100 | - | 175,456 | 193,483 | - | - | - | 193,483 |
| Utilities | 73,978 | - | - | - | 73,978 | 72,821 | - | - | - | 72,821 |
| Administrative | 72,342 | 111,908 | 53,623 | 102,172 | 340,045 | 70,224 | 55,785 | - | 6,070 | 132,079 |
| Program | 79,842 | - | 1,860 | - | 81,702 | 59,168 | - | - | - | 59,168 |
| Insurance and taxes | 20,622 | - | - | - | 20,622 | 15,670 | 2,880 | - | - | 18,550 |
| Fundraising (Note 7) | - | - | 73,766 | 54,005 | 127,771 | - | - | 114,084 | 188,016 | 302,100 |
| Depreciation | 77,704 | - | - | - | 77,704 | 150,027 | 16,670 | - | - | 166,697 |
| Total expenses as shown on the Statement of Activities | 1,052,813 | 291,798 | 281,046 | 254,877 | 1,880,534 | 1,110,415 | 220,513 | 234,957 | 223,624 | 1,789,509 |
| Cost of special events | - | - | 427,214 | - | 427,214 | - | - | 335,023 | - | 335,023 |
| Total expenses | $ 1,052,813 | $ 291,798 | $ 708,260 | $ 254,877 | $ 2,307,748 | $ 1,110,415 | $ 220,513 | $ 569,980 | $ 223,624 | $ 2,124,532 |

*The accompanying notes are an integral part of these financial statements.*

FAMILY HOUSE, INC.

*(A California Nonprofit Public Benefit Corporation)*

STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2012 AND 2011

| | 2012 | 2011 |
|---|---|---|
| Cash flows from operating activities: | | |
| Change in net assets | $ 2,970,454 | $ 4,986,136 |
| Adjustments to reconcile change in net assets to net cash provided by operating activities: | | |
| Depreciation | 77,704 | 166,697 |
| Realized and unrealized (gain) loss on investments | (342,683) | 63,343 |
| (Increase) decrease in assets: | | |
| Contributions receivable | (1,588,457) | (4,101,819) |
| Prepaid expenses | 728 | 21,683 |
| Increase (decrease) in liabilities: | | |
| Accounts payable and accrued expenses | 222 | 14,171 |
| Deferred revenue | 6,850 | (2,600) |
| Net cash provided by operating activities | 1,124,818 | 1,147,611 |
| Cash flows from investing activities: | | |
| Net change in investments | (261,711) | (15,840) |
| Net change in restricted cash | (640,302) | (899,074) |
| Purchase of property, equipment and development in progress | (150,219) | (86,772) |
| Net cash used in investing activities | (1,052,232) | (1,001,686) |
| Increase in cash | 72,586 | 145,925 |
| Cash, beginning of year | 695,462 | 549,537 |
| Cash, end of year | $ 768,048 | $ 695,462 |

*The accompanying notes are an integral part of these financial statements.*

## NOTE 1 – ORGANIZATION AND NATURE OF ACTIVITIES

Family House, Inc. (FH) was formed in 1980. Its mission is to serve as a home away from home for families of children with cancer and other life-threatening illnesses by providing physical comfort and emotional support, free from financial concerns. FH maintains residential real properties in San Francisco to accomplish this purpose, and serves over two thousand families per year.

FH operates the following buildings, named Koret Family House, at the following locations:

*50 Irving Street, San Francisco, CA* – Purchased in 1981 and located directly across from the University of California San Francisco Medical Center (UCSF). The residence has ten family bedrooms plus group kitchens and family rooms. The corporate offices are also at this location.

*1234 Tenth Avenue, San Francisco, CA* – This three-story property is located near UCSF and across from Golden Gate Park. It was purchased in 2001 and two stories became operational in November 2002 with the remainder placed in service in early 2003. It has 24 family bedrooms plus group kitchens and family rooms. FH mounted a capital campaign to retire the debt and provide funds for the renovations.

## NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

*Accounting Method*

FH uses the accrual method of accounting, which recognizes income in the period earned and expenses when incurred, regardless of the timing of payments.

*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 disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

FH records contributions receivable based on its estimate of collectibility. Should such estimate change over the next 12 months, any portion of the currently reported amounts may be deemed uncollectible.

*Basis of Presentation*

FH reports information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets.

*Revenue Recognition*

Contributions are recognized as revenue when they are unconditionally communicated. Grants represent contributions if resource providers receive no value in exchange for the assets transferred. Contributions are recorded at their fair value as unrestricted support, temporarily restricted support or permanently restricted support, depending on the absence or existence of donor-imposed restrictions as applicable. When a restriction expires (that is when a stipulated time restriction ends or purpose restriction is accomplished), temporarily restricted net assets are reclassified to unrestricted net assets and reported in the Statements of Activities as net assets released from restrictions. If donors' restrictions are satisfied in the same period that the contribution is received, the contribution is reported as unrestricted support. Contributions restricted for the purchase of long-lived assets are reported as unrestricted support when expended.

FH acquired certain property in prior years for nominal amounts or by charitable contribution. These assets were recorded at their estimated fair value as of the acquisition date, and these amounts may materially differ from current values.

Contributed services are stated at their estimated fair value, if they are ordinarily purchased and are of a specialized nature, or if they enhance a non-financial asset.

*Cash*

Cash is defined as cash in demand deposit accounts as well as cash on hand. Not included as cash are funds restricted as to their use, regardless of liquidity, such as funds provided by donors for a specified purpose which are included in temporarily restricted net assets. The organization occasionally maintains cash on deposit at a bank in excess of the Federal Deposit Insurance Corporation or Securities Investor Protection Corporation limit. The uninsured cash and investments balance was approximately $1,741,000 as of December 31, 2012. FH has not experienced any losses in such account.

*Contributions Receivable*

FH records an allowance for doubtful collections based on a review of outstanding receivables, historical collection information, and existing economic conditions. The allowance for doubtful collections was $56,014 and $-0- as of December 31, 2012 and 2011, respectively.

*Investments*

Under generally accepted accounting principles, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (exit price) in an orderly transaction between market participants at the measurement date.

Generally accepted accounting principles establish a fair value hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are those that market participants would use in pricing the asset or liability based on market data obtained from sources independent of FH. Unobservable inputs, if any, reflects FH's assumption about the inputs market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. The fair value hierarchy is categorized into three levels based on the inputs as follows:

Level 1 – Valuations based on unadjusted quoted prices in active markets for identical assets or liabilities that the FH has the ability to access at measurement date. Valuation adjustments and block discounts are not applied to Level 1 securities. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these securities does not entail a significant degree of judgment.

Level 2 – Valuations based on significant inputs that are observable, either directly or indirectly or quoted prices in markets that are not active, that is, markets in which there are few transactions, the prices are not current or price quotations vary substantially either over time or among market makers.

Level 3 – Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

The availability of valuation techniques and observable inputs can vary from security to security and is affected by a wide variety of factors, including the type of security, whether the security is new and not yet established in the marketplace, and other characteristics particular to the transaction. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment. Those estimated values do not necessarily represent the amounts that may be ultimately realized due to the occurrence of future circumstances that cannot be reasonably determined. Because of the inherent uncertainty of valuation, those estimated values may be materially higher or lower than the values that would have been used had a ready market for the securities existed.

*Property and Equipment*

Property and equipment is stated at cost of acquisition, construction, or fair value if donated. The costs of maintenance and repairs are charged to expense as incurred. Depreciation is computed based on the straight-line method over the estimated useful lives of the assets.

The useful lives of the assets are estimated as follows:

| | |
|---|---|
| Buildings and improvements | 30 years |
| Furniture and equipment | 5 years |
| Off-site improvements | 5 years |

*Development in Progress*

FH incurs costs during the pre-development and development phase of the building project undertaken. Such costs include governmental fees, legal and consulting fees needed to investigate the feasibility and arrange for the financing of the project under consideration, as well as construction costs. FH records these costs to an asset account (development in progress) and the costs are usually recoverable from loan proceeds and contributions. Project development costs are considered to be development in progress until the project is placed in service. Development in progress is not depreciated until the completion of development.

Any funds expended on the project that do not pass beyond the predevelopment stage are recorded as expense when activity on the project ceases. FH estimates that no portion of development in progress is unrealizable at December 31, 2012 and 2011 (see Note 7).

*Income Taxes*

FH is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code and the related California code sections.

FH believes that it has appropriate support for any tax positions taken, and as such, does not have any uncertain tax positions that are material to the financial statements. FH's federal and state information returns for the years 2008 through 2011 have been filed and are subject to examination by regulatory agencies, generally for three years and four years after they were filed for federal and state, respectively.

*Functional Expenses Allocation*

The costs of providing program services and supporting services are summarized on a functional basis in the Statements of Activities and Statements of Functional Expenses. Accordingly, certain costs are allocated among program services and supporting services based on estimates of employees' time incurred and on usage of resources.

*Compensated Absences*

Compensated absences are not accrued. Accounting principles generally accepted in the United States of America require that compensated absences be accrued. However, the effect of not accruing compensated absences is not materially different from the result that would have been obtained had compensated absences been accrued.

*Reclassification*

Certain amounts previously reported in the 2011 financial statements were reclassified to conform to the 2012 presentation for comparative purposes.

*Subsequent Events*

Management has evaluated subsequent events through July 18, 2013, the date on which the financial statements were available to be issued.

**NOTE 3 – INVESTMENTS**

Investments at December 31, 2012 and 2011 are summarized as follows:

| | 2012 | 2011 |
|---|---|---|
| Funds | $ 3,058,437 | $ 2,458,666 |
| Individual equities | 10,665 | 6,042 |
| Total investments | $ 3,069,102 | $ 2,464,708 |

Realized and unrealized gain (loss) on investments for 2012 and 2011 were $342,683 and $(63,343), respectively.

FH investments recorded at fair value have been categorized based upon Level 1 hierarchy of inputs in accordance with generally accepted accounting principles. See Note 2 for a discussion of FH's policies.

The total fair value of investments as of December 31, 2012 and 2011, respectively includes $1,308,378 and $1,141,918 of donor-restricted endowment funds (see Note 6) and related investment income. The donor restricted endowment funds also include $6,282 and $23,213 of restricted cash as of December 31, 2012 and 2011, respectively.

FH's investment portfolio is being managed by an independent and reputable third-party investment manager.

The following presents investments by category at fair value as of December 31, 2012:

| | *Non-Endowment* | *Endowment* | *Total* |
|---|---|---|---|
| Funds: | | | |
| Exchange traded funds | $ 401,058 | $ 323,135 | $ 724,193 |
| Large value/blend equity funds | 301,610 | 208,807 | 510,417 |
| Intermediate-term bond index funds | 282,848 | 212,443 | 495,291 |
| Short-term bond funds | 229,682 | 170,577 | 400,259 |
| Small/mid-capitalization index funds | 159,092 | 114,878 | 273,970 |
| Inflation-protected bond funds | 92,582 | 66,195 | 158,777 |
| World bond funds | 98,777 | 73,862 | 172,639 |
| International equity funds | 86,541 | 67,839 | 154,380 |
| Diversified emerging markets equity funds | 72,142 | 54,498 | 126,640 |
| Real estate equity funds | 25,727 | 16,144 | 41,871 |
| Total | 1,750,059 | 1,308,378 | 3,058,437 |
| Individual equities: | | | |
| Common stock – other | 10,665 | - | 10,665 |
| Total | 10,665 | - | 10,665 |
| Total | $ 1,760,724 | $ 1,308,378 | $ 3,069,102 |

The following presents investments by category at fair value as of December 31, 2011:

| | *Non-Endowment* | *Endowment* | *Total* |
|---|---|---|---|
| Funds: | | | |
| Exchange traded funds | $ 317,009 | $ 275,236 | $ 592,245 |
| Large value/blend equity funds | 239,475 | 206,282 | 445,757 |
| Intermediate-term bond index funds | 198,025 | 171,821 | 369,846 |
| Short-term bond funds | 160,327 | 141,780 | 302,107 |
| Small/mid-capitalization index funds | 122,176 | 105,404 | 227,580 |
| Inflation-protected bond funds | 89,859 | 77,268 | 167,127 |
| World bond funds | 70,577 | 60,764 | 131,341 |
| International equity funds | 62,473 | 54,289 | 116,762 |
| Diversified emerging markets equity funds | 34,929 | 30,151 | 65,080 |
| Real estate equity funds | 21,898 | 18,923 | 40,821 |
| Total | 1,316,748 | 1,141,918 | 2,458,666 |
| Individual equities: | | | |
| Common stock – other | 6,042 | - | 6,042 |
| Total | 6,042 | - | 6,042 |
| Total | $ 1,322,790 | $ 1,141,918 | $ 2,464,708 |

**NOTE 4 – PROPERTY AND EQUIPMENT**

Property and equipment is summarized as follows:

| | 2012 | 2011 |
|---|---|---|
| Land | $ 1,256,051 | $ 1,256,051 |
| Buildings and improvements | 4,044,989 | 4,044,989 |
| Furniture and equipment | 431,630 | 431,630 |
| Off-site improvements | 7,450 | 7,450 |
| | 5,740,120 | 5,740,120 |
| Less: accumulated depreciation | (2,112,042) | (2,034,338) |
| Total property and equipment | $ 3,628,078 | $ 3,705,782 |

**NOTE 5 – TEMPORARILY RESTRICTED NET ASSETS**

Temporarily restricted net assets are summarized as follows:

| | 2012 | | | |
|---|---|---|---|---|
| | *December 31, 2011* | *Contributions* | *Releases from Restrictions* | *December 31, 2012* |
| Facilities maintenance | $ 10,000 | $ 5,000 | $ - | $ 15,000 |
| Mission Bay capital campaign (Note 7) | 4,885,279 | 2,234,409 | - | 7,119,688 |
| Endowment earnings – time restricted until appropriated for expenditures (Note 6) | 84,349 | 149,529 | - | 233,878 |
| | $ 4,979,628 | $ 2,388,938 | $ - | $ 7,368,566 |

| | 2011 | | | |
|---|---|---|---|---|
| | *December 31, 2010* | *Contributions* | *Releases from Restrictions* | *December 31, 2011* |
| Facilities maintenance | $ - | $ 10,000 | $ - | $ 10,000 |
| Mission Bay capital campaign (Note 7) | - | 4,885,279 | - | 4,885,279 |
| Program services | 17,746 | - | (17,746) | - |
| Endowment earnings – time restricted until appropriated for expenditures (Note 6) | 115,910 | - | (31,561) | 84,349 |
| | $ 133,656 | $ 4,895,279 | $ (49,307) | $ 4,979,628 |

**NOTE 6 – ENDOWMENT FUNDS**

Over the years, FH has received certain funds designated as permanently restricted. FH established the Arthur R. Ablin Endowment Fund of Family House. The primary funding of the endowment came from an estate, of which FH was the sole beneficiary. The endowment fund is managed by an independent and reputable third-party investment manager. As required by generally accepted accounting principles (GAAP), net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

*Interpretation of Relevant Law*

The Board of Directors of Family House has interpreted the State Prudent Management of Institutional Funds Act (the Act) as requiring the preservation of the fair value of the original gifts as of the date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, FH classifies as permanently restricted net assets (1) the original value of gifts donated to the permanent endowment, (2) the original value of subsequent gifts to the permanent endowment, and (3) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund, if any. The remaining portion of the donor-restricted endowment fund, including endowment earnings, that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the organization in a manner consistent with the standard of prudence of the Act.

In accordance with the Act, Family House considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

(a) The duration and preservation of the fund.
(b) The purposes of the organization and the donor-restricted endowment fund.
(c) General economic conditions.
(d) The possible effect of inflation and deflation.
(e) The expected total return from income and the appreciation of investments.
(f) Other resources of the organization.
(g) The investment policies of the organization.

Changes in endowment net assets for the fiscal years ended December 31, 2012 and 2011 are as follows:

| | *Unrestricted* | *Temporarily Restricted* | *Permanently Restricted* | *Total* |
|---|---|---|---|---|
| December 31, 2010 | $ - | $ 115,910 | $ 1,080,782 | $ 1,196,692 |
| Investment return (loss): | | | | |
| Net unrealized depreciation | - | (31,561) | - | (31,561) |
| December 31, 2011 | - | 84,349 | 1,080,782 | 1,165,131 |
| Investment return: | | | | |
| Net unrealized appreciation | - | 149,529 | - | 149,529 |
| December 31, 2012 | $ - | $ 233,878 | $ 1,080,782 | $ 1,314,660 |

*Funds with Deficiencies*

From time to time, the fair value of assets associated with the donor-restricted endowment funds may fall below the level that the donor or the Act requires Family House to retain as a fund of perpetual duration. In accordance with GAAP, deficiencies of this nature are reported as decreases in unrestricted net assets. These deficiencies may result from unfavorable market fluctuations or other market conditions. There were no such deficiencies as of December 31, 2012 and 2011.

*Return Objectives and Risk Parameters*

The Endowment Account is intended to accumulate as much capital appreciation as possible, with the eventual goal of helping to support Family House's on-going operations while leaving the accumulated principal intact. Given this objective, investments assume a moderate to high degree of risk with diversification among different asset classes as a means of reducing risk. The Endowment Account can and will tolerate short-term portfolio volatility in an effort to achieve higher expected long-term rate of return.

*Strategies Employed for Achieving Objectives*

To meet the return objectives and risk parameters, guidelines for the management of the Endowment Account have been established.

Asset allocation ranges are set for the various asset classes: a target asset allocation of 55% equities and 45% fixed income is adopted. Actual asset allocation may vary from target but equities and fixed income may not exceed 10% of the portfolio at market value. Endowment investments do not include illiquid assets, such as real estate, and acceptable and unacceptable investments for each asset class have been determined.

*Spending Policy and How the Investment Objectives Relate to Spending Policy*

At this time, Family House's policy is to reinvest all earnings. Family House's board of directors may determine the amount that will be used to help fund Family House's annual operations. The spending of earnings will be limited to the annual earnings of the portfolio and will not exceed seven percent (7%) of the fair value of the endowment fund. The fair value of the endowment fund will be calculated on the basis of market values determined at least quarterly and averaged over a period of not less than three (3) years immediately proceeding the year in which the appropriation for expenditure is made.

## NOTE 7 – MISSION BAY CAPITAL CAMPAIGN

FH was informed by UCSF that in 2015, UCSF will open a new hospital in the San Francisco Mission Bay area and has requested FH to relocate its existing facilities adjacent to the new hospital in order to continue its mission of serving as a home away from home for the families of seriously ill children being treated at UCSF. FH's Management and Board approved the relocation of FH's facilities and has launched a capital campaign in 2011 to raise funds for the acquisition of land and construction of the new facility (the project). During 2012 and 2011, FH incurred pre-development costs for the project. Such costs include legal and consulting fees needed to acquire land and to design the new facility. FH recorded these costs as development in progress. As of December 31, 2012 and 2011, capitalized development in progress costs was $226,570 and $76,351, respectively. Certain costs incurred to raise funds and to study the feasibility of fundraising were not capitalized and were expensed as fundraising expense. Total fundraising incurred for the Mission Bay capital campaign during 2012 and 2011 were $254,877 and $223,624, respectively. A separate bank account was established and restricted for the project. As of December 31, 2012, the restricted account balance was $1,560,379. A total of $2,639,442 and $5,162,754 of Mission Bay capital campaign contributions were recorded in 2012 and 2011, respectively.

Management intends to sell the Irving Street and Tenth Avenue properties once the move to San Francisco Mission Bay is completed.

In April 2011, FH received a conditional contribution from the Kalmanovitz Charitable Foundation (KCF) through the UCSF Foundation to contribute $4,000,000 for the specific purpose of building a new Family House facility in the San Francisco Mission Bay area. The contribution is to be made in five equal installments of $800,000 commencing in 2011 through 2015. The funds shall be paid upon proof by FH that dollar-for dollar grant funds have been secured or pledged from other funding sources. KCF shall make a payment up to the amount of the funds actually raised or pledged not to exceed $800,000 per year. As of 2012, a total of $3,904,119 was matched, and a matching KCF donation was recorded accordingly. As agreed, KCF initially contributed the funds to the UCSF Foundation in trust, and FH is expecting the funds to be transferred from the UCSF Foundation beginning in 2014. As of December 31, 2012, total KCF funds held by the UCSF Foundation totaled $1,600,000 and are included in capital campaign receivable.

The remaining balance of the KCF conditional pledge of $95,881 is not reflected in these financial statements until the matching condition is met.

**NOTE 8 – RETIREMENT PLAN**

FH had established a 403b plan covering employees who work more than 25 hours a week, as defined in the plan. Employees are not required to contribute to the plan and employee contributions are immediately vested. The employer contribution to the plan is 3% of employees' annual salary excluding bonuses with an additional 3% matching if employees contribute at least 3% to the plan. Employer contributions were $41,493 and $33,366 annually for the years ended December 31, 2012 and 2011, respectively.