

Houston Endowment Inc.

Financial Statements

Years Ended December 31, 2008 and 2007

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Report of Independent Auditors

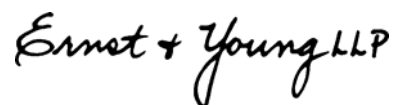
Board of Directors
Houston Endowment Inc.

We have audited the accompanying statements of assets and fund balance arising from cash transactions of Houston Endowment Inc. (the Foundation) as of December 31, 2008 and 2007, and the related statements of revenues, expenditures, and changes in fund balance arising from cash transactions for the years then ended. These financial statements are the responsibility of the Foundation's management. 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Foundation's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Foundation's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note 1, these financial statements have been prepared on a modified basis of cash receipts and disbursements that generally follows accounting principles used for federal excise tax purposes, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States.

In our opinion, the financial statements referred to above present fairly, in all material respects, the assets and fund balance arising from cash transactions of Houston Endowment Inc. at December 31, 2008 and 2007, and its revenues, expenditures, and changes in fund balance for the years then ended, on the basis of accounting described in Note 1.



September 10, 2009

Houston Endowment Inc.

Statements of Assets and Fund Balance

	December 31	
	2008	2007
Assets		
Cash, cash equivalents, and short-term investments	\$ 60,076,370	\$ 26,388,268
Marketable securities:		
Equity investments	805,110,606	836,354,294
Fixed-income investments	250,596,906	320,814,490
Accrued interest and dividends	5,162,783	8,981,744
Total marketable securities and related receivables	<u>1,060,870,295</u>	<u>1,166,150,528</u>
Other investments	326,457,718	285,495,304
Real property	16,643,177	6,624,417
Other assets (net of depreciation)	990,365	1,052,140
Total assets	<u>\$ 1,465,037,925</u>	<u>\$ 1,485,710,657</u>
Fund balance		
Appropriated for grants payable in future years	\$ 77,023,621	\$ 71,571,395
Unappropriated fund balance	1,388,014,304	1,414,139,262
Total fund balance	<u>\$ 1,465,037,925</u>	<u>\$ 1,485,710,657</u>

See accompanying notes.

Houston Endowment Inc.

Statements of Revenues, Expenditures, and Changes in Fund Balance

	Years Ended December 31	
	2008	2007
Revenues:		
Dividends	\$ 23,228,408	\$ 34,812,908
Interest	10,662,857	15,142,532
Partnership income	7,406,460	1,430,072
Royalties and rents	6,879,267	5,591,272
Other income	1,363,078	368,732
	<u>49,540,070</u>	<u>57,345,516</u>
Expenditures:		
Investment expenses	10,882,179	10,593,070
Administrative expenses	3,323,011	3,144,830
Federal excise taxes	1,925,000	3,750,000
	<u>16,130,190</u>	<u>17,487,900</u>
Excess of revenues over expenditures before grant payments	33,409,880	39,857,616
Grant payments (<i>Note 4</i>)	76,630,364	66,260,835
Excess of expenditures over revenues	<u>(43,220,484)</u>	<u>(26,403,219)</u>
Fund balance at beginning of year	1,485,710,657	1,338,767,885
Realized capital gains	22,547,752	173,345,991
Fund balance at end of year	<u>\$ 1,465,037,925</u>	<u>\$ 1,485,710,657</u>

See accompanying notes.

Houston Endowment Inc.

Notes to Financial Statements

December 31, 2008

1. Significant Accounting Policies

Reporting Entity

Houston Endowment Inc. (the Foundation) was incorporated in 1937 as a nonprofit organization for the purpose of supporting charitable, educational, and religious undertakings. The Foundation invests its endowment funds and uses the return from the investments to make grants to charitable organizations.

Basis of Accounting

The Foundation reports on the modified cash basis of accounting generally following accounting principles used for federal excise tax purposes. Revenues are recognized when cash is received or when amounts are taxed, and expenditures are recognized when cash is disbursed. Accordingly, grants to charitable organizations are recognized as expenditures when paid. Accounts do not include interest and dividends receivable, amortization of bond premiums, accretion of bond discounts, federal excise tax payable, or other liabilities unless subject to federal excise tax in the current period.

Reclassifications

Certain reclassifications have been made to the Foundation's prior-period financial statements in order to conform to the current-year presentation.

Cash, Cash Equivalents, and Short-Term Investments

The Foundation considers all highly liquid investments having original maturities of three months or less to be cash equivalents and all investments having original maturities of one year or less to be short-term investments.

Marketable Securities

Marketable securities are recorded at cost on the date of acquisition.

Other Investments

Other investments include nonmarketable securities, such as limited partnerships of private equity and real estate investments, and are recorded at cost on the date of acquisition.

Houston Endowment Inc.

Notes to Financial Statements (continued)

1. Significant Accounting Policies (continued)

Real Property

Investments in real property are recorded at cost.

Other Assets

Other assets (including leasehold improvements, furniture, equipment, and software used in the operations of the Foundation) are recorded at cost. Where appropriate, these assets are depreciated using the straight-line method based on their estimated useful lives.

Fund Balance

Grants approved to be paid in a future year are reflected as appropriated fund balance until paid. Unappropriated fund balance includes the amount of the original endowment, gains recognized on sales and other dispositions of assets, and net revenues in excess of expenditures. Realized net capital gains are added directly to the unappropriated fund balance.

Federal Excise Taxes

The Foundation qualifies as a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code of 1986 and, accordingly, is not subject to federal income tax on investment income. However, the Foundation is classified as a private foundation and is subject to an excise tax on net investment income. The Foundation made estimated payments during 2008 under the assumption that the excise tax owed would be at the 2% rate. However, by year-end, the Foundation satisfied certain requirements as to the level of distributions to charitable organizations and, thus, qualified to pay excise taxes at a 1% rate, which will equal approximately \$650,000. In 2007, the Foundation paid excise tax at the rate of 2% of net investment income, which equaled \$4,443,407. See Note 4.

Consistent with a modified cash basis of accounting, federal excise taxes are recorded when estimated payments are made, final payments are made, or refunds are received. Accordingly, federal excise tax expense on the statements of revenues, expenditures, and changes in fund balance may be substantially more or less than the actual tax attributable to any individual year.

Houston Endowment Inc.

Notes to Financial Statements (continued)

2. Retirement Benefits

The Foundation has a defined benefit pension plan covering its employees. Since 2006, the plan has been overfunded and no contributions have been allowed. The defined benefit pension plan is funded in amounts sufficient to meet the minimum requirements of the Employee Retirement Income Security Act of 1974. As of October 1, 2008, the date of the latest actuarial valuation, the Adjusted Funding Target Attainment Percentage, as defined by the Pension Protection Act of 2006, was 100.7%.

The Foundation also has a voluntary defined contribution plan that provides retirement benefits to participating employees. Employees are eligible for participation upon completion of 30 days of continuous service. The Foundation's contributions are based upon a percentage of employee contributions. The Foundation's contributions to the plan were approximately \$99,250 and \$92,000 in 2008 and 2007, respectively.

3. Lease Obligations

Future minimum rental payments under the noncancelable operating lease for office space for the next five years and thereafter and in the aggregate are as follows:

Year ending December 31:	
2009	\$ 541,997
2010	547,597
2011	558,796
2012	372,531
2013	—
Thereafter	—
Total	<u>\$ 2,020,921</u>

4. Grant Payments

As previously noted, grant payments are recorded on a cash basis.

The amount of grants paid each year differs from the amount budgeted for grant spending for that year for various reasons. Grants deferred from prior years or pending payment are due to contingencies or restrictions on the grants that had not been met by the grant recipient organization. Grant payments are sometimes accelerated for excise tax planning purposes.

Houston Endowment Inc.

Notes to Financial Statements (continued)

4. Grant Payments (continued)

In 2008, net grant payments totaled \$76,630,364 and included the following:

Grants budgeted for 2008 and paid in 2008	\$75,024,439
Payments in 2008 on grants deferred from prior years	1,168,435
Accelerated payments in 2008 on grants payable in future years	—
Directors and staff matching gifts program	403,783
Director-initiated grants	436,000
	<u>77,032,657</u>
Grant refunds received	<u>(402,293)</u>
Total	<u>\$76,630,364</u>

For 2008, the board of directors approved a grant spending budget of \$93,071,789, which was allocated as follows:

Grants budgeted for 2008 and paid in 2008	\$75,024,439
Grants budgeted for 2008 with payment accelerated in prior years	1,500,000
Grants budgeted for 2008 but pending payment	5,856,761
Other payments counted as grant spending for 2008	130,000
Directors and staff matching gifts program	403,783
Director-initiated grants	436,000
Unspent 2008 budget carried forward to 2009	9,720,806
Total	<u>\$93,071,789</u>

5. Market Value of Assets (unaudited)

The statements of assets and fund balance and the related statements of revenues, expenditures, and changes in fund balance do not include any unrealized gains or losses due to changes in the market value of assets.

Houston Endowment Inc.

Notes to Financial Statements (continued)

5. Market Value of Assets (unaudited) (continued)

At December 31, 2008 and 2007, the market value of the Foundation's assets is as follows:

	<u>2008</u>	<u>2007</u>
Cash, cash equivalents, and short-term investments	\$ 59,018,365	\$ 26,398,399
Marketable securities:		
Equity investments	554,098,044	964,162,593
Fixed-income investments	253,009,983	339,092,522
Accrued interest and dividends	6,487,239	11,976,479
Total marketable securities and related receivables	<u>813,595,266</u>	1,315,231,594
Other investments	315,316,977	352,945,446
Real property	58,980,198	52,143,262
Other assets (net of depreciation)	899,493	1,122,874
Total assets	<u>\$ 1,247,810,299</u>	<u>\$ 1,747,841,575</u>

Market values of marketable securities and short-term investments are based upon published quotations. Dividends and interest receivable are stated at the accrued amount. The market value of other investments and assets is determined by management.

The value of real property is determined by independent appraisers and is updated at least every five years.