Discovery Green Conservancy

Financial Statements
and Independent Auditors' Report
for the years ended June 30, 2017 and 2016

Blazek & Vetterling
CERTIFIED PUBLIC ACCOUNTANTS

Independent Auditors' Report

To the Board of Directors of
Discovery Green Conservancy:

We have audited the accompanying financial statements of Discovery Green Conservancy, which comprise the statements of financial position as of June 30, 2017 and 2016 and the related statements of activities and of cash flows for the years then ended, and the related notes to the financial statements.

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

Auditors' Responsibility – Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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, financial position of Discovery Green Conservancy as of June 30, 2017 and 2016 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.

Blazek & Vetterling

September 27, 2017

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Discovery Green Conservancy

Statements of Financial Position as of June 30, 2017 and 2016

	2017	2016
ASSETS		
Cash	$ 1,365,094	$ 680,616
Restaurant rent receivable	106,968	121,614
Receivable from Houston First Corporation *(Note 9)*	214,662	
Prepaids and other receivables	150,817	112,945
Operating pledges receivable, net *(Note 3)*	184,845	210,500
Cash designated or restricted for capital improvements	967,003	999,177
Pledges receivable for capital improvements, net *(Note 4)*		48,395
Property and equipment, net *(Note 5)*	37,311,528	38,028,072
TOTAL ASSETS	$ 40,300,917	$ 40,201,319
LIABILITIES AND NET ASSETS		
Liabilities:		
Accounts payable	$ 264,574	$ 94,789
Accrued salaries and benefits	177,263	180,547
Deferred revenue *(Note 10)*	979,443	72,027
Total liabilities	1,421,280	347,363
Net assets:		
Unrestricted *(Note 6)*	38,363,384	39,234,729
Temporarily restricted *(Note 7)*	516,253	619,227
Total net assets	38,879,637	39,853,956
TOTAL LIABILITIES AND NET ASSETS	$ 40,300,917	$ 40,201,319

See accompanying notes to financial statements.

Discovery Green Conservancy

Statement of Activities for the year ended June 30, 2017

	UNRESTRICTED	TEMPORARILY RESTRICTED	TOTAL
REVENUE:			
Venue rental *(Note 10)*	$ 2,373,430		$ 2,373,430
Management fees from Houston First Corporation *(Note 9)*	1,553,941		1,553,941
Restaurant rental income *(Note 11)*	1,281,055		1,281,055
Contributions	941,390	$ 92,782	1,034,172
In-kind contributions *(Note 8)*	861,913		861,913
Special events	169,513		169,513
Direct donor benefits	(24,067)		(24,067)
Total revenue	7,157,175	92,782	7,249,957
Net assets released from restrictions:			
Expiration of time restrictions	105,532	(105,532)	
Capital expenditure	82,474	(82,474)	
Satisfaction of purpose restrictions	7,750	(7,750)	
Total	7,352,931	(102,974)	7,249,957
EXPENSES:			
Program expenses:			
Park operations	6,649,883		6,649,883
Park operations – in-kind *(Note 8)*	703,146		703,146
Total program expenses	7,353,029		7,353,029
Management and general	653,715		653,715
Fundraising	217,532		217,532
Total expenses	8,224,276		8,224,276
CHANGES IN NET ASSETS	(871,345)	(102,974)	(974,319)
Net assets, beginning of year	39,234,729	619,227	39,853,956
Net assets, end of year	$ 38,363,384	$ 516,253	$ 38,879,637

See accompanying notes to financial statements.

Discovery Green Conservancy

Statement of Activities for the year ended June 30, 2016

	UNRESTRICTED	TEMPORARILY RESTRICTED	TOTAL
REVENUE:			
Venue rental *(Note 10)*	$ 1,083,170		$ 1,083,170
Management fees from Houston First Corporation *(Note 9)*	1,137,787		1,137,787
Restaurant rental income *(Note 11)*	1,179,761		1,179,761
Contributions	678,904	$ 277,749	956,653
In-kind contributions *(Note 8)*	900,755		900,755
Special events	1,158,650		1,158,650
Direct donor benefits	(379,280)		(379,280)
Total revenue	5,759,747	277,749	6,037,496
Net assets released from restrictions:			
Expiration of time restrictions	109,466	(109,466)	
Capital expenditure	664,463	(664,463)	
Satisfaction of purpose restrictions	74,266	(74,266)	
Total	6,607,942	(570,446)	6,037,496
EXPENSES:			
Program expenses:			
Park operations	5,223,574		5,223,574
Park operations – in-kind *(Note 8)*	707,865		707,865
Total program expenses	5,931,439		5,931,439
Management and general	676,809		676,809
Fundraising	211,603		211,603
Total expenses	6,819,851		6,819,851
CHANGES IN NET ASSETS	(211,909)	(570,446)	(782,355)
Net assets, beginning of year	39,446,638	1,189,673	40,636,311
Net assets, end of year	$ 39,234,729	$ 619,227	$ 39,853,956

See accompanying notes to financial statements.

Discovery Green Conservancy

Statements of Cash Flows for the years ended June 30, 2017 and 2016

	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES:		
Changes in net assets	$ (974,319)	$ (782,355)
Adjustments to reconcile changes in net assets to net cash provided (used) by operating activities:		
Depreciation	912,916	951,928
Contributions restricted for property and equipment		(200,000)
Changes in operating assets and liabilities:		
Restaurant rent receivable	14,646	13,460
Receivable from Houston First Corporation	(214,662)	
Prepaids and other receivables	(37,872)	38,968
Operating pledges receivable	25,655	(76,901)
Accounts payable	169,785	(2,306)
Accrued salaries and benefits	(3,284)	25,514
Deferred revenue	907,416	(158,347)
Net cash provided (used) by operating activities	800,281	(190,039)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net change in cash designated or restricted for capital improvements	32,174	459,912
Cash paid for property and equipment	(196,372)	(597,961)
Net cash used by investing activities	(164,198)	(138,049)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from contributions restricted for property and equipment	48,395	403,990
NET CHANGE IN CASH AND CASH EQUIVALENTS	684,478	75,902
Cash and cash equivalents, beginning of year	680,616	604,714
Cash and cash equivalents, end of year	$ 1,365,094	$ 680,616

See accompanying notes to financial statements.

NOTE 1 – ORGANIZATION

Organization – Discovery Green Conservancy (the Conservancy) is a nonprofit organization incorporated in 2004. The Conservancy is responsible for the operation and promotion of a downtown park (Discovery Green) located across from the George R. Brown Convention Center in downtown Houston, Texas.

In 2004, the Conservancy entered into a Development Management Agreement with the Houston Downtown Park Corporation (the Corporation) for the design, development, financing, and construction management of Discovery Green. The Corporation is a Texas nonprofit local government corporation created by the City of Houston (the City) to acquire and hold land for Discovery Green and to contract for the design, development, construction, operation, and promotion of Discovery Green. Upon acquisition of approximately twelve acres of land for Discovery Green, the Conservancy transferred the land to the Corporation, but retained an amenities easement. The amenities easement was used for construction of light retail, restaurant, and other amenities for park users. Discovery Green was completed in April 2008. The Conservancy funded approximately $35 million of leasehold improvements for the development of Discovery Green.

The Conservancy entered into an Operating Agreement with the Corporation to operate Discovery Green for an initial term of 50 years commencing on April 8, 2008, the date of the park dedication. The agreement includes two 25-year renewal terms. Under the Operating Agreement, the Conservancy is paid an annual management fee by the City through Houston First Corporation, a City component unit (see Note 9). The Conservancy must operate Discovery Green in accordance with the Operating Agreement, which requires that the property be used solely as an urban park and restricts the types of events that can be held at Discovery Green. It also gives the right to the Conservancy to market Discovery Green and to establish reasonable venue rental rates and park rules.

Federal income tax status – The Conservancy 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)(1) and §170(b)(1)(A)(vi).

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Pledges 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.

Property and equipment is reported at cost, if purchased, or at fair value at the date of gift, if donated. The Conservancy capitalizes property and equipment that have a cost or fair value of $1,000 or greater and an estimated useful life of more than one year. The Conservancy recognizes depreciation for leasehold improvements and furniture, fixtures and equipment using the straight-line method over the estimated useful lives of the assets, ranging from 5 to 50 years. Works of art are not depreciated.

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

Net asset classification – Contributions and the related net assets are classified based on the existence or absence of donor-imposed restrictions, as follows:

- *Unrestricted net assets* include those net assets whose use is not restricted by donor-imposed stipulations, even though their use may be limited in other respects, such as by contract or board designation.
- *Temporarily restricted net assets* include contributions restricted by the donor for specific purposes or time periods. When a purpose restriction is accomplished or a time restriction ends, temporarily restricted net assets are released to unrestricted net assets.

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. Conditional contributions are recognized in the same manner when the conditions are substantially met.

Special event revenue is recognized when the event occurs. Amounts received in advance are reported as deferred revenue until earned.

Management fees and venue rental income are recognized when the related services are provided. Venue rentals received in advance are reported as deferred revenue until earned.

Restaurant rental income (excluding contingent rentals) is recognized on a straight-line basis over the scheduled lease term. Contingent rental income is recognized as revenue on a monthly basis as the leasee achieves the specified target.

In-kind materials, use of facilities, and services – In-kind 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.

Advertising costs are expensed as incurred. Advertising expense of $842,924 was recognized in 2017 and $745,039 in 2016.

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 of reported revenue and expenses, and the allocation of expenses among various functions. Actual results could vary from the estimates that were used.

Recent financial accounting pronouncement – In August 2016, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities.* The amendments in this ASU are the first phase of changes aimed at providing more useful information to users of not-for-profit financial statements. Under this ASU, net assets will be presented in two classes: *net assets with donor restrictions* and *net assets without donor restrictions* and underwater endowments will be grouped with *net assets with donor restrictions.* New or enhanced disclosures will be required about the nature and composition of net assets, and the liquidity and availability of resources for general operating expenditures within one year of the balance sheet date. Expenses will be required to be presented by both nature and function and investment return will be presented net of external and direct internal investment expenses. Absent explicit donor stipulations, restrictions on long-lived assets will expire when assets are placed in service. The ASU is effective for fiscal periods beginning after December 15, 2017, but early adoption is permitted. Adoption of this ASU will impact the presentation and disclosures of the financial statements.

NOTE 3 – PLEDGES RECEIVABLE

Pledges receivable consist of the following:

	2017	2016
Pledges receivable	$ 184,845	$ 260,800
Discount to net present value at 2% to 5%		(1,905)
Pledges receivable, net	$ 184,845	$ 258,895

Pledges receivable at June 30, 2017 are expected to be collected in fiscal 2018.

NOTE 4 – CONDITIONAL PLEDGE RECEIVABLE

The Conservancy has initiated a capital campaign to fund improvements to Discovery Green as outlined in its Master Plan. These improvements include:

- New gateways into Discovery Green.
- Additional public restrooms.
- New playground facility and children's garden with shade structure.
- Interactive signage consoles.
- New lighting plan.
- Five-year Art Installation program.
- New sidewalk pavers along Avenida de las Americas.

During 2017, the Conservancy received a conditional pledge of $3,000,000 from a foundation for the Master Plan project. The commitment is conditioned upon the commencement of construction related to the Master Plan. The contribution will be recognized when the condition is substantially met.

NOTE 5 – PROPERTY AND EQUIPMENT

Property and equipment is comprised of the following:

	2017	2016
Leasehold improvements	$ 35,787,313	$ 35,787,313
Furniture, fixtures and equipment	2,483,952	2,326,825
Depreciable property and equipment, at cost	38,271,265	38,114,138
Accumulated depreciation	(8,115,476)	(7,228,804)
Depreciable property and equipment, net	30,155,789	30,885,334
Dubuffet sculpture	6,786,119	6,786,119
Art exhibit and sculpture	170,757	170,757
Construction in progress	198,863	185,862
Property and equipment, net	$ 37,311,528	$ 38,028,072

NOTE 6 – UNRESTRICTED NET ASSETS

Unrestricted net assets consist of the following:

	2017	2016
Property and equipment, net	$ 37,311,528	$ 38,028,072
Undesignated	551,856	706,657
Board-designated maintenance fund	500,000	500,000
Total unrestricted net assets	$ 38,363,384	$ 39,234,729

NOTE 7 – TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets are available for the following purposes:

	2017	2016
Renovation and repairs campaign	$ 268,519	$ 350,993
Dubuffet sculpture maintenance fund	198,484	198,484
Time restricted	49,250	69,750
Total temporarily restricted net assets	$ 516,253	$ 619,227

NOTE 8 – IN-KIND CONTRIBUTIONS

In-kind contributions were recognized as follows:

	2017	2016
Advertising – park operations	$ 673,518	$ 612,524
Advertising – management and general	145,327	67,552
Legal services – management and general	13,440	124,815
Other – park operations	29,628	95,341
Other – management and general		523
Total in-kind contributions	$ 861,913	$ 900,755

NOTE 9 – HOUSTON FIRST CORPORATION MANAGEMENT FEES

In fiscal year 2017, the Conservancy entered into an agreement with Houston First Corporation to manage the event scheduling at Avenida Plaza effective one year from March 2017, renewing for four one-year terms. The annual management fee is $120,000 beginning March 2017 plus reimbursement of costs of performances up to $1,000,000 per year. Revenue of $403,000 was reported in fiscal year 2017. At June 30, 2017, an accounts receivable of $214,662 is due from Houston First Corporation.

The Conservancy also reported management fees for operating Discovery Green totaling $1.2 million and $1.1 million in fiscal year 2017 and fiscal year 2016, respectively.

NOTE 10 – FACILITY LICENSE AGREEMENT

In 2017, the Conservancy entered into an agreement with a communications company to enhance wireless capabilities at Discovery Green by creating a common wireless communication network available to all wireless carriers by utilizing existing structures and therefore, minimizing the visual impact on Discovery Green. The effective date of the agreement is August 15, 2016 for an initial term of ten years with automatic renewals of three additional five-year terms unless written notice is provided by either party within 180 days. The fee for the initial ten-year term is $550,000, which was received in fiscal year 2017. As of June 30, 2017, $495,000 is recorded as deferred revenue and $55,000 was recognized as venue rental income. Over the initial term of the agreement, Discovery Green will recognize future rent revenue as follows:

2018	$ 55,000
2019	55,000
2020	55,000
2021	55,000
2022 and thereafter	275,000
Total minimum lease payments	$ 495,000

NOTE 11 – RESTAURANT LEASE

In 2007, the Conservancy entered into a License and Concession Agreement with an organization for the construction and operation of the restaurants at Discovery Green. The initial term of the lease is ten years with two five-year renewal options. Under the agreement, the Conservancy receives a base rent determined as a percentage of annual gross revenue with a minimum base rent of $500,000 per year during the renewal term of the lease (contingent rent). The contingent rent is adjusted for inflation after the initial term. The agreement provides for additional rent equal to the amortization of a pre-opening allowance of $1,020,000, plus interest. The payment of the additional rent commenced in October 2008.

The future minimum rent (including the minimum base contingent rent) as of June 30, 2017 is $316,283 which is due in fiscal year 2018.

Contingent rent of $1,067,860 and $951,763 is included in restaurant rental income for fiscal years 2017 and 2016, respectively.

Restaurant leasehold improvements are approximately $8.9 million at June 30, 2017, and are included in property and equipment in the statement of financial position. Accumulated depreciation on the leasehold improvements under the operating lease was approximately $1,700,000 and $1,521,000 at June 30, 2017 and 2016, respectively.

NOTE 12 – SUBSEQUENT EVENTS

Management has evaluated subsequent events through September 27, 2017, 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.