

**DIRECT RELIEF INTERNATIONAL
AND
DIRECT RELIEF FOUNDATION
COMBINED FINANCIAL STATEMENTS
June 30, 2009**

**DIRECT RELIEF INTERNATIONAL AND
DIRECT RELIEF FOUNDATION**

June 30, 2009

TABLE OF CONTENTS

	<u>Page</u>
Independent Auditor's Report	1
Financial Statements:	
Statement of Financial Position	2
Statement of Activities and Changes in Net Assets	3
Statement of Functional Expenses	4
Statement of Cash Flows	5
Notes to Financial Statements	6 - 16



CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS

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INDEPENDENT AUDITOR'S REPORT

Board of Directors
Direct Relief International and Direct Relief Foundation
Santa Barbara, California

We have audited the accompanying combined statement of financial position of Direct Relief International and Direct Relief Foundation (non-profit corporations) as of June 30, 2009, and the related combined statements of activities and changes in net assets, functional expenses, and cash flows for the year then ended. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of Direct Relief International and Direct Relief Foundation as of June 30, 2009, and the changes in net assets and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Signed

November 23, 2009

**DIRECT RELIEF INTERNATIONAL AND DIRECT RELIEF FOUNDATION
(NON-PROFIT CORPORATIONS)**

**COMBINED STATEMENT OF FINANCIAL POSITION
JUNE 30, 2009**

(in thousands)

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Assets				
Current assets:				
Cash and cash equivalents	\$ 6,630	\$ 1,976	\$ -	\$ 8,606
Investments	22,874	-	25	22,899
Contributions and other receivables	185	-	-	185
Inventories	43,947	-	-	43,947
Prepaid expenses	164	-	-	164
Total current assets	<u>73,800</u>	<u>1,976</u>	<u>25</u>	<u>75,801</u>
Property and equipment - net of accumulated depreciation of \$1.565M	5,872	-	-	5,872
Bequests receivable	-	268	-	268
Other assets	3	-	-	3
Total assets	<u>\$ 79,675</u>	<u>\$ 2,244</u>	<u>\$ 25</u>	<u>\$ 81,944</u>
Liabilities and Net Assets				
Liabilities:				
Current liabilities:				
Accounts payable	\$ 355	\$ -	\$ -	\$ 355
Current portion of capital lease	5	-	-	5
Other current liabilities	514	-	-	514
Total current liabilities	<u>874</u>	<u>-</u>	<u>-</u>	<u>874</u>
Long-term debt	1,400	-	-	1,400
Capital lease obligation	3	-	-	3
Distribution payable - split interest agreements	-	8	-	8
Total liabilities	<u>2,277</u>	<u>8</u>	<u>-</u>	<u>2,285</u>
Net assets:				
Unrestricted net assets:				
Board designated reserve fund	30,235	-	-	30,235
Undesignated	47,163	-	-	47,163
Total unrestricted net assets	<u>77,398</u>	<u>-</u>	<u>-</u>	<u>77,398</u>
Temporarily restricted assets	<u>-</u>	<u>2,236</u>	<u>-</u>	<u>2,236</u>
Permanently restricted assets	<u>-</u>	<u>-</u>	<u>25</u>	<u>25</u>
Total net assets	<u>77,398</u>	<u>2,236</u>	<u>25</u>	<u>79,659</u>
Total liabilities and net assets	<u>\$ 79,675</u>	<u>\$ 2,244</u>	<u>\$ 25</u>	<u>\$ 81,944</u>

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

**DIRECT RELIEF INTERNATIONAL AND DIRECT RELIEF FOUNDATION
(NON-PROFIT CORPORATIONS)**

**COMBINED STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS
FOR THE YEAR ENDED JUNE 30, 2009**

(in thousands)

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Public support and revenue				
Public support:				
In cash and securities:				
Contributions	\$ 4,485	\$ 1,472	\$ -	\$ 5,957
Corporate and foundation grants	237	1,630	-	1,867
Workplace giving campaigns	281	-	-	281
Special events	60	-	-	60
Total public support from cash and securities	<u>5,063</u>	<u>3,102</u>	<u>-</u>	<u>8,165</u>
From donated goods and services:				
Pharmaceuticals, medical supplies and equipment	156,833	-	-	156,833
Contributed freight	750	-	-	750
Contributed goods - other	25	-	-	25
Professional services received	261	-	-	261
Total from donated goods and services	<u>157,869</u>	<u>-</u>	<u>-</u>	<u>157,869</u>
Total public support	162,932	3,102	-	166,034
Revenue:				
Investment income	560	18	-	578
Loss on sale of investments	(6,632)	-	-	(6,632)
Change in value - split interest agreements	-	63	-	63
Unrealized loss on investments	(4,273)	-	-	(4,273)
Program service fees	2	-	-	2
Total revenue	<u>(10,343)</u>	<u>81</u>	<u>-</u>	<u>(10,262)</u>
Net assets released from restrictions:	4,250	(4,250)	-	-
Total public support and revenue	156,839	(1,067)	-	155,772
Expenses				
Program services:				
Medical supplies and related expenses	170,832			170,832
Supporting services:				
Administration	2,225			2,225
Fundraising	987			987
Total supporting services	<u>3,212</u>	<u>-</u>	<u>-</u>	<u>3,212</u>
Total expenses	<u>174,044</u>	<u>-</u>	<u>-</u>	<u>174,044</u>
Change in net assets	(17,205)	(1,067)	-	(18,272)
Net asset balance beginning of the year	<u>94,603</u>	<u>3,303</u>	<u>25</u>	<u>97,931</u>
Net asset balance end of the year	<u>\$ 77,398</u>	<u>\$ 2,236</u>	<u>\$ 25</u>	<u>\$ 79,659</u>

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

**DIRECT RELIEF INTERNATIONAL AND DIRECT RELIEF FOUNDATION
(NON-PROFIT CORPORATIONS)**

**COMBINED STATEMENT OF FUNCTIONAL EXPENSES
FOR THE YEAR ENDED JUNE 30, 2009**

(in thousands)

	Program Services			Total Program Services	Supporting Services		Total Program and Supporting Services June 30, 2009
	Domestic Services	International Services	International Disaster		Administration	Fundraising	
Compensation and related benefits:							
Salaries	\$ 563	\$ 1,401	\$ 38	\$ 2,002	\$ 862	\$ 505	\$ 3,369
Payroll taxes	38	95	3	136	60	35	231
Employee benefits	64	159	4	227	109	59	395
Total compensation and related benefits	665	1,655	45	2,365	1,031	599	3,995
Other expenses							
Pharmaceuticals, medical equipment and supplies distributed - donated	28,147	104,770	14,305	147,222	-	-	147,222
Pharmaceuticals, medical equipment and supplies distributed - procured	171	410	90	671	-	-	671
Inventory adjustment (expired pharmaceuticals)	2,581	10,899	-	13,480	-	-	13,480
Accounting and legal fees	2	15	-	17	72	1	90
Advertising	-	-	-	-	5	14	19
Bank charges	-	-	-	-	35	-	35
Contract services	170	616	49	835	379	56	1,270
Contributed services	3	9	-	12	207	43	262
Contributed freight	144	606	-	750	-	-	750
Contributed goods	-	-	-	-	17	8	25
Disposal costs (expired pharmaceuticals)	3	13	-	16	1	-	17
Dues and subscriptions	10	33	-	43	14	3	60
Duplicating and printing	1	1	-	2	83	41	126
Equipment and software maintenance	13	49	-	62	23	12	97
Equipment rental	2	6	-	8	3	2	13
Freight and transportation	165	1,393	188	1,746	-	-	1,746
Grants and stipends	313	1,189	516	2,018	-	-	2,018
Insurance	9	39	-	48	10	1	59
Interest	15	62	-	77	7	2	86
Meetings, conferences, special events	7	13	-	20	47	33	100
Outside computer services	-	1	-	1	-	30	31
Postage and mailing services	5	15	4	24	29	35	88
Rent and other occupancy	74	340	-	414	3	1	418
Supplies	36	119	1	156	22	16	194
Taxes, licenses and fees	15	7	-	22	21	-	43
Training and education	3	11	-	14	6	3	23
Travel and automobile	33	191	13	237	30	13	280
Utilities and telephone	15	94	1	110	20	5	135
Web Hosting	22	86	-	108	42	18	168
Total expenses before depreciation	32,624	122,642	15,212	170,478	2,106	936	173,520
Depreciation and amortization	72	282	-	354	119	51	524
Total functional expenses - June 30, 2009	\$ 32,696	\$ 122,924	\$ 15,212	\$ 170,832	\$ 2,225	\$ 987	\$ 174,044

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

**DIRECT RELIEF INTERNATIONAL AND DIRECT RELIEF FOUNDATION
(NON-PROFIT CORPORATIONS)
COMBINED STATEMENTS OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2009**

(in thousands)

	Total June 30, 2009
Cash flows from operating activities:	
Cash collected from public support	\$ 7,678
Cash paid for goods and services	(10,993)
Dividend and interest income	578
Other income	2
Net cash used by operating activities	(2,735)
Cash flows from investing activities:	
Purchase of investments	(25,554)
Proceeds from sale of investments	34,758
Purchase of capital assets	(1,126)
Unitrust distribution	(11)
Net cash provided by investing activities	8,067
Cash flows from financing activities:	
Payments on capital lease obligation	(4)
Net cash used for financing activities	(4)
Net increase in cash and cash equivalents	5,329
Cash and cash equivalents - beginning of year	3,277
Cash and cash equivalents - end of year	\$ 8,606
Reconciliation of change in net assets to net cash used by operating activities:	
Change in net assets	\$ (18,272)
Adjustments to reconcile change in net assets to net cash used by operating activities:	
Depreciation	524
Change in inventory	3,802
Change in receivables	(485)
Change in prepaid expenses and other assets	(710)
Change in accounts payable and accrued expenses	1,501
Realized loss on sale of investments	6,632
Unrealized loss on investments	4,273
Net cash used by operating activities	\$ (2,735)

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

DIRECT RELIEF INTERNATIONAL AND DIRECT RELIEF FOUNDATION

NOTES TO COMBINED FINANCIAL STATEMENTS

Note 1: Organization

Direct Relief International (DRI), a California non-profit public benefit corporation, was founded in 1948.

DRI's program services consist of providing essential pharmaceuticals, medical supplies and medical equipment to support health services in medically underserved communities on an ongoing humanitarian basis and in response to emergency situations and disasters around the world. In the United States, DRI's activities focus on the delivery of donated medicines and supplies to uninsured patients through the support of nonprofit clinics and health centers treating low-income patients. In Santa Barbara and surrounding communities, DRI conducts programs dedicated to improving the oral health of children from low-income families and enhancing disaster preparedness efforts. Under agreements with local emergency response authorities, DRI's medical inventories are available on an as-needed basis in the event of a health emergency. The medical material resources provided as part of DRI's assistance program are either purchased or received by donation from pharmaceutical and medical supplies manufacturers, wholesalers, and other organizations involved in the health care industry.

The Direct Relief Foundation (Foundation) was formed and incorporated in the state of California as a supporting organization of DRI in October 2006. The Foundation is organized to operate solely and exclusively to support, benefit, or to carry out the purposes of DRI. Except to an insubstantial degree, the Foundation does not carry on or engage in any activities or exercise any powers that are not in furtherance of the purposes of DRI. The Foundation began operations on April 1, 2007.

Note 2: Summary of Significant Accounting Policies

Change in Fiscal Year:

In 2008, the Board of Directors for both Direct Relief International and Direct Relief Foundation (the combination hereinafter referred to as the "Organization") approved changing the Organization's fiscal year from a March 31 year end to a June 30 year end. An interim, or "short", fiscal year was required to bridge the old and new twelve-month reporting periods. The Organization's short fiscal year began April 1, 2008 and ended June 30, 2008. These statements represent the first full fiscal year.

Basis of Presentation:

These notes and accompanying combined financial statements include DRI and the Foundation. All material inter-organizational accounts and transactions have been eliminated. The combined financial statements have been prepared on an accrual basis in accordance with accounting principles generally accepted in the United States of America.

No comparative information has been included since this the first full fiscal year following the short fiscal year.

DIRECT RELIEF INTERNATIONAL AND DIRECT RELIEF FOUNDATION

NOTES TO COMBINED FINANCIAL STATEMENTS

Revenues, expenses, gains, and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, the net assets of the Organization and changes therein are classified and reported as follows:

Unrestricted net assets — Net assets that are not subject to any donor-imposed restrictions.

Temporarily restricted net assets — Net assets subject to donor-imposed restrictions on their use that may be met either by actions of the Organization or the passage of time.

Permanently restricted net assets — Net assets subject to donor-imposed or other legal restrictions requiring that the principal be maintained permanently by the Organization.

Use of Estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities in the financial statements. Actual results could differ from management's estimates.

Cash Equivalents:

The Organization considers all highly-liquid investments purchased with an average maturity of three months or less to be cash equivalents. Cash equivalents, consisting of money market mutual funds and checking account balances, were valued at \$8.6 million as of June 30, 2009.

Investments:

Effective April 1, 2007, DRI transferred its separately managed investment fund to the Foundation. This fund is professionally managed under guidelines approved by the Board of Directors, with income and principal if necessary being drawn to meet current expenses of the Organization to the extent approved by the Board. Investments are reported at fair market values provided by the fund managers or general partners.

Valuation of Future Interests:

The Organization serves as trustee of a unitrust, of which it is the charitable beneficiary. The Organization is also the beneficiary of several charitable remainder trusts. The future interests in the unitrust and charitable remainder trusts are recorded as assets and valued at fair value on the date of each gift. Investments in the trust are adjusted to fair value at the end of each year. The present value of the total estimated future distributions to the donors on the date of each gift is recorded as a liability. The present value of the Organization's interest in each of the charitable remainder trusts is also adjusted on an annual basis.

DIRECT RELIEF INTERNATIONAL AND DIRECT RELIEF FOUNDATION

NOTES TO COMBINED FINANCIAL STATEMENTS

Inventories:

Purchased inventory is carried at average cost. Donated inventory is carried at average estimated wholesale value as of the date of receipt. Inventory balances as of June 30, 2009, were composed of the following (in thousands):

Pharmaceuticals	\$ 38,818
Medical supplies/kits	2,595
Equipment	2,534
Total inventories	<u>\$ 43,947</u>

Property and Equipment:

Property and equipment purchased are recorded at cost. Donated assets are capitalized at the estimated fair value on the date of receipt. Depreciation is computed using the straight-line method over the estimated useful lives of the assets as follows:

<u>Class of property</u>	<u>Estimated useful life</u>
Buildings	40
Building improvements	20
Equipment and software	3-10

Revenue Recognition:

Contributions, which include unconditional promises to give (pledges), are recognized as revenue in the period received or promised. Conditional contributions are recorded when the conditions have been met. Contributions are considered to be unrestricted unless specifically restricted by the donor.

The Organization reports contributions in the temporarily or permanently restricted net asset class if they are received with donor-imposed restrictions as to their use. When the restriction expires - the time restriction ends or purpose of restriction is accomplished - temporarily restricted net assets are released and reclassified to unrestricted net assets in the statement of activities. Donor-restricted contributions are initially reported in the temporarily restricted net asset class, even if it is anticipated that such restrictions will be met in the current reporting year.

Contributed Materials and Services:

Contributions of pharmaceutical and medical supplies are recorded at estimated wholesale value on the date received, based on published wholesale price indexes for pharmaceuticals and medical supplies, or if not available, based on other Internet pricing sources as applicable. Contributions of medical equipment are recorded at estimated wholesale value based upon wholesale price guides or other Internet pricing sources as applicable.

Donated or contributed services are reported at fair value in the financial statements for voluntary donations of services when those services (1) create or enhance non-financial assets or (2) require specialized skills provided by individuals possessing those skills and are services which would be typically purchased if not provided by donation. Donated shipping is valued at the Organization's

DIRECT RELIEF INTERNATIONAL AND DIRECT RELIEF FOUNDATION

NOTES TO COMBINED FINANCIAL STATEMENTS

discounted percentage of full published rates in effect at the time of shipment. The value of donated services and shipping is also recorded as an equivalent expense in the same period in which the services are received.

Income Taxes:

DRI and the Foundation are not-for-profit organizations that are exempt from income taxes under Section 501(c) (3) of the Internal Revenue Code and State of California Revenue and Taxation Code Section 23701(d); therefore, no provision for income taxes is required.

Pursuant to FSP Fin 48-3, management has elected to defer the application of FASB Interpretation No. 48 – Accounting for Uncertainty in Income Taxes to fiscal years beginning after December 15, 2008. The Organization evaluates uncertain tax positions in accordance with FASB statement No. 5, Accounting for Contingencies whereby the effect of the uncertainty would be recorded if the outcome was considered probably and reasonably estimable. As of June 30, 2009, the Organization had no uncertain tax positions requiring accrual.

Joint Costs:

During the year the Organization incurred joint costs of \$110 thousand for informational materials that included fundraising appeals. The Organization allocated \$83 thousand to administration expense and \$27 thousand to fund raising expense.

Note 3: Investments

The Organization has adopted SFAS No. 124, “Accounting for Certain Investments Held by Not-for-Profit Organizations”. This statement requires that nonprofit organizations record investments at fair market value in the statements of financial position. As of June 30, 2009, all the investments were held by the Foundation. Investment holdings as of June 30, 2009, are composed of the following (in thousands):

	2009	
	Cost	Fair Value
Equity securities	\$ 8,093	\$ 6,952
Fixed income securities	6,949	6,168
Commodities	1,098	737
Alternative investments	10,873	9,042
Total investments	<u>\$ 27,013</u>	<u>\$ 22,899</u>

DIRECT RELIEF INTERNATIONAL AND DIRECT RELIEF FOUNDATION

NOTES TO COMBINED FINANCIAL STATEMENTS

The following summarizes the net change in unrealized loss on investments (in thousands):

	<u>Cost</u>	<u>Fair Value</u>	<u>Deficit of Fair Value Over Cost</u>
Balance at end of the year	\$ 27,013	\$ 22,899	\$ (4,114)
Balance at the beginning of the year	<u>42,781</u>	<u>42,940</u>	<u>159</u>
Net change in unrealized loss on Investments			<u>\$ (4,273)</u>

The Organization had investment expenses of \$67 thousand during the twelve months ended June 30, 2009.

Note 4: Fair Value Measurements

Fair values of assets have been measured in accordance with SFAS No. 157 "Fair Value Measurements" ("FAS 157"). FAS 157 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy under FAS 157 are as follows:

- Level 1 Inputs that reflect unadjusted quoted prices in active markets for identical assets accessible at the measurement date;
- Level 2 Inputs other than quoted prices that are observable for the asset either directly or indirectly, including inputs in markets that are not considered to be active;
- Level 3 Inputs that are unobservable.

Inputs broadly refer to the assumptions that are used to make valuation decisions, including assumptions about risk.

Fair values of assets measured on a recurring basis at June 30, 2009, are as follows (in thousands):

	<u>Fair Value</u>	<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
Equity securities	\$ 6,952	\$ 6,123	\$ 302	\$ 527
Fixed income securities	6,168	48	5,311	809
Commodities	737	24	568	145
Alternative investments	9,042	611	270	8,161
Receivables	<u>453</u>	<u>-</u>	<u>-</u>	<u>453</u>
Total	<u>\$ 23,352</u>	<u>\$ 6,806</u>	<u>\$ 6,451</u>	<u>\$ 10,095</u>

DIRECT RELIEF INTERNATIONAL AND DIRECT RELIEF FOUNDATION

NOTES TO COMBINED FINANCIAL STATEMENTS

Assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3):

	<u>Equity securities</u>	<u>Fixed income securities</u>	<u>Commodities</u>	<u>Alternative investments</u>	<u>Receivables</u>	<u>Total</u>
July 1, 2008	\$ 4,432	\$ 1,981	\$ 278	\$ 9,124	\$ 563	\$ 16,378
Total gains and losses (realized/unrealized)	(1,363)	(90)	(123)	(2,280)	(44)	(3,900)
Purchases, redemptions, fees and settlements	(1,791)	(318)	(49)	2,198	(66)	(26)
Transfers in and/or out of level 3	<u>(751)</u>	<u>(764)</u>	<u>39</u>	<u>(881)</u>	<u>-</u>	<u>(2,357)</u>
June 30, 2009	<u>\$ 527</u>	<u>\$ 809</u>	<u>\$ 145</u>	<u>\$ 8,161</u>	<u>\$ 453</u>	<u>\$ 10,095</u>

Note 5: Property and Equipment

The Organization's investment in property and equipment as of June 30, 2009, consisted of the following (in thousands):

Land	\$ 1,364
Office and warehouse	3,243
Vehicles, equipment and software	<u>2,830</u>
Total	7,437
Less: Accumulated Depreciation	<u>(1,565)</u>
Net Property and Equipment	<u>\$ 5,872</u>

Note 6: Debt

The Organization's debt as of June 30, 2009, consists of a mortgage note payable, requiring monthly interest only payments of \$7,047 at 6.04% per annum through November 20, 2012. Principal and interest payments commence on December 20, 2012 and the loan matures on November 20, 2017. The mortgage notes are secured by the Organization's warehouse facility.

As of June 30, 2009, the Organization had future minimum payments as follows for the years ending June 30 (in thousands):

2010	\$ -
2011	-
2012	-
2013	166
2014	285
Thereafter	<u>949</u>
Total	<u>\$ 1,400</u>

DIRECT RELIEF INTERNATIONAL AND DIRECT RELIEF FOUNDATION

NOTES TO COMBINED FINANCIAL STATEMENTS

Note 7: Net Assets

Unrestricted net assets consisted of the following at June 30, 2009 (in thousands):

Designated by the Board of Directors for:	
Operating reserves	\$ 30,235
Undesignated	<u>47,163</u>
Total unrestricted net assets	<u>\$ 77,398</u>

Temporarily restricted net assets are available for the following purposes at June 30, 2009 (in thousands):

Myanmar recovery efforts	\$ 258
Bucket Brigade–Fire Truck project	197
China earthquake recovery efforts	185
Tsunami recovery efforts	157
Hurricane Katrina recovery efforts	98
Southern California fire relief efforts	71
Program–specific grants	822
Country–specific assistance	127
Other activities	<u>321</u>
Total temporarily restricted net assets	<u>\$ 2,236</u>

Permanently restricted net assets consists of an endowed contribution of \$25 thousand, the income from which is available to fund general operations.

Note 8: Endowment Funds

The Organization’s endowment consists of 2 individual funds; (1) the Donor Restricted Endowment Fund and (2) the Board Restricted Investment Fund (“BRIF”). The Donor Restricted Endowment Fund includes “Temporary” or “Permanently” restricted funds which have been so designated and restricted by the donors. As required by GAAP, net assets associated with endowment funds, including Board designated funds, are classified and reported based on the existence or absence of donor-imposed restrictions. The majority of the donor-restricted endowment fund is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Organization in a manner consistent with the standard for prudence prescribed by the Universal Prudent Management of Institutional Funds Act (UPMIFA) which the state of California has adopted.

The purpose of the BRIF is to provide a reserve for future operations. The BRIF’s resources come from board-designated unrestricted bequests and gifts, return on the Fund’s portfolio assets and operating surpluses (measured annually) in excess of current operational needs. Effective April 1, 2007, the assets in the BRIF were all transferred to the Foundation.

DIRECT RELIEF INTERNATIONAL AND DIRECT RELIEF FOUNDATION

NOTES TO COMBINED FINANCIAL STATEMENTS

Fiscal year ended June 30, 2009 endowment net asset composition by type of fund is (in thousands):

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted	\$ -	\$ 1,314	\$ 25	\$ 1,339
Board-restricted (BRIF)	<u>30,235</u>	<u>-</u>	<u>-</u>	<u>30,235</u>
Total endowment funds	<u>\$ 30,235</u>	<u>\$ 1,314</u>	<u>\$ 25</u>	<u>\$ 31,574</u>

Changes in the endowment net assets for the year ended June 30, 2009 (in thousands) are:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, beginning of year	\$ 44,037	\$ 1,720	\$ 25	\$ 45,782
Net investment return (investment income, realized and unrealized gains and losses)	(10,335)	-	-	(10,335)
Contributions	483	63		546
Appropriation of endowment assets for expenditure	<u>(3,950)</u>	<u>(469)</u>	<u>-</u>	<u>(4,419)</u>
Endowment net assets, end of year	<u>\$ 30,235</u>	<u>\$ 1,314</u>	<u>\$ 25</u>	<u>\$ 31,574</u>

During the year the market value of the Organization's investment portfolio in the endowment was severely impacted by the world-wide financial crisis. As a result, the Organization has experienced a decline of approximately 22% of the value of its investments since June 30, 2008. In November 2008 facing the continuing uncertainty of the investment environment and the need to insure liquidity for operational needs, the Organization decided to create an operating reserve of \$8.7 million to cover anticipated expenses for a two year period, these funds to be held in highly-liquid and minimal principal risk United States Government securities. As a result of the rebalancing the Organization realized a loss of approximately \$6.7 million. Since then it has continued to maintain these in highly liquid money market securities, certificates of deposit and a bond fund.

DIRECT RELIEF INTERNATIONAL AND DIRECT RELIEF FOUNDATION

NOTES TO COMBINED FINANCIAL STATEMENTS

Return Objectives and Risk Parameters

The Organization has adopted investment and spending policies for the endowment assets that attempt to provide a predictable stream of funding to the Organization while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the Organization must hold in perpetuity or for a donor-specified period as well as board-designated funds. 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 provide a reasonable balance between the quest for growth and the need to protect principal. The Organization expects its endowment funds, over time, to provide an average rate of return of approximately 7 percent annually. Actual returns in any given year may vary from this amount.

Strategies Employed for Achieving Objectives

To satisfy its long-term rate-of return objectives, the Organization 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 Organization targets a diversified asset allocation that currently is equally balanced between equity and fixed income investments to achieve its short term spending needs as well the long-term objectives, within prudent risk constraints.

Spending Policy and How the Investment Objectives Relate to Spending Policy

The Organization has a policy of appropriating for distribution each year an amount up to five percent of the assets of the BRIF. In some instances, the Board may decide to appropriate an amount greater than its stated policy if it is specifically deemed prudent to do so. The BRIF is authorized to distribute its portfolio assets to pay for all fundraising and administration expenses, including extraordinary capital expenses and advance emergency disaster relief funding as determined by the President & CEO. Upon a majority vote by the Board, the BRIF may also be utilized to meet other general operational costs. For the twelve months ended June 30, 2009, \$2.806 million was distributed to cover all fundraising and administration costs.

Note 9: Pension Expense

The Organization established the Direct Relief International 401(k) Plan (the Plan) on January 1, 2004. Employees of the Organization are eligible to participate upon hire and are vested 100 percent in all contributions to the Plan. The Organization matches every dollar contributed, up to five (5) percent of the employee's annual compensation, subject to Board approval.

The Organization's contributions to the Plan amounted to \$120 thousand for the twelve months ended June 30, 2009.

The Organization also maintains a tax-deferred annuity plan established under Internal Revenue Code section 403(b) for employees who joined the Organization prior to January 1, 2004. There have been no contributions to this 403(b) plan since the establishment of the Plan.

DIRECT RELIEF INTERNATIONAL AND DIRECT RELIEF FOUNDATION

NOTES TO COMBINED FINANCIAL STATEMENTS

Note 10: Non-Qualified Deferred Compensation Agreement

The Organization is party to a non-qualified deferred compensation agreement with the surviving spouse of a co-founder of the Organization. Under the terms of the agreement, beginning January 1, 1971, the Organization is obligated to make monthly payments in acknowledgement of his 23 years of service. The retirement agreement expense for the twelve months ended June 30, 2009, was \$10 thousand.

Note 11: Concentrations of Credit Risk

Financial instruments that potentially subject the Organization to concentrations of credit risk consist principally of bank and brokerage deposits. The Organization places its temporary cash investments with financial institutions and brokerages. For the twelve months ended June 30, 2009, the Organization was at risk for \$6.4 million in cash deposited at individual financial institutions. The Federal Deposit Insurance Corporation (FDIC) insures individual deposits up to \$250 thousand. In addition, the Organization's investments are exposed to various risks, such as interest rate fluctuations and market valuations. Due to the level of risk associated with certain investment securities and the level of uncertainty related to changes in the value of investment securities, it is at least reasonably possible that changes in risks in the near term could materially affect the Organization's statement of financial position and the statement of activities.

Note 12: Concentrations of Income Risk

The Organization received 33% of its current year cash contributions from ten single donors and 78% of its current year in-kind contributions from ten corporate donors.

Note 13: Leases

The Organization is leasing 23,043 square feet of storage space located at 30 S. La Patera Lane. The terms of this agreement end on December 31, 2012. Payments for rent and common area expenses for the twelve months ended June 30, 2009, totaled \$330 thousand.

As of June 30, 2009, the Organization had future minimum payments for the storage space lease and common area expenses as follows for the years ending June 30 (in thousands):

2010	\$ 343
2011	351
2012	360
2013	<u>182</u>
Total	<u>\$ 1,236</u>

The Organization is also leasing three Kyocera photocopiers used in operations. Leased property having elements of ownership are recorded as capital leases in the Statement of Financial Position. The related obligations, in amounts equal to the present value of the minimum lease payments payable during the remaining term of the lease, are recorded in the long-term debt account group. Total payments on such leases for the twelve months ending June 30, 2009, were \$4 thousand.

DIRECT RELIEF INTERNATIONAL AND DIRECT RELIEF FOUNDATION

NOTES TO COMBINED FINANCIAL STATEMENTS

The cost of assets under capital leases totaled \$21 thousand and accumulated depreciation of these assets was \$13 thousand as of June 30, 2009. Depreciation expense was \$4 thousand for the twelve months ending June 30, 2009. Amortization of assets held under capital lease is included with depreciation expense.

As of June 30, 2009, the Organization had future minimum payments under capital leases of \$5 thousand for the next year and \$3 thousand in the last year, with a total of \$3 hundred representing the remaining interest expense.

Note 14: Subsequent Events

In preparing these financial statements, the Organization has evaluated events and transactions for potential recognition or disclosure through November 23, 2009, the date the financial statements were issued.