

AUDITED FINANCIAL STATEMENTS
THE KROGER CO. FOUNDATION
CINCINNATI, OHIO
FEBRUARY 1, 2014

C O N T E N T S

INDEPENDENT AUDITOR'S REPORT	3
STATEMENTS OF FINANCIAL POSITION.....	4
STATEMENTS OF ACTIVITIES	5
STATEMENTS OF CASH FLOWS.....	6
NOTES TO FINANCIAL STATEMENTS.....	7-11

INDEPENDENT AUDITOR'S REPORT

To the Board of Trustees
The Kroger Co. Foundation

We have audited the accompanying financial statements of The Kroger Co. Foundation, an Ohio Corporation not-for-profit, which comprise the statements of financial position as of February 1, 2014, and February 2, 2013, and the related statements of activities 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.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Kroger Co. Foundation as of February 1, 2014, and February 2, 2013, 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.

Mellott & Mellott, P.L.L.

Cincinnati, Ohio
May 27, 2014

- 3 -

THE KROGER CO. FOUNDATION
 STATEMENTS OF FINANCIAL POSITION
 FEBRUARY 1, 2014 AND FEBRUARY 2, 2013

<u>ASSETS</u>	<u>2014</u>	<u>2013</u>
<u>CURRENT ASSETS</u>		
Cash and cash equivalents	\$ 824,281	\$ 729,587
Accounts receivable, sundry	37,020	34,031
Investments	36,352,343	37,787,948
Deferred excise tax	<u>2,851</u>	<u>-</u>
TOTAL CURRENT ASSETS	<u>\$37,216,495</u>	<u>\$38,551,566</u>
 <u>LIABILITIES AND NET ASSETS</u>		
<u>CURRENT LIABILITIES</u>		
Grants payable	\$ 1,690,849	\$ 1,272,323
Accrued expense	17,200	16,700
Accrued excise tax	4,525	30,964
Deferred excise tax	<u>-</u>	<u>24,294</u>
TOTAL CURRENT LIABILITIES	<u>1,712,574</u>	<u>1,344,281</u>
 <u>NET ASSETS</u>		
Unrestricted net assets	<u>35,503,921</u>	<u>37,207,285</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$37,216,495</u>	<u>\$38,551,566</u>

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

THE KROGER CO. FOUNDATION
STATEMENTS OF ACTIVITIES
FOR THE YEARS ENDED FEBRUARY 1, 2014 AND FEBRUARY 2, 2013

	<u>2014</u>	<u>2013</u>
<u>REVENUE, GAINS (LOSSES) AND OTHER SUPPORT</u>		
Contributions	\$ 5,523,893	\$ 5,637,286
Net realized and unrealized gains (losses) on investments	(1,273,809)	2,449,085
Interest and dividends	<u>3,592,804</u>	<u>1,772,045</u>
TOTAL REVENUE, GAINS (LOSSES) AND OTHER SUPPORT	<u>7,842,888</u>	<u>9,858,416</u>
<u>EXPENSES</u>		
Grants	9,486,955	8,181,975
Federal excise tax expense (benefit)	(8,174)	25,586
Miscellaneous	586	852
Professional services	18,113	23,345
Registration fees	2,772	3,237
Scholarship program expense	<u>46,000</u>	<u>46,000</u>
TOTAL EXPENSES	<u>9,546,252</u>	<u>8,280,995</u>
<u>CHANGE IN UNRESTRICTED NET ASSETS</u>	(1,703,364)	1,577,421
<u>UNRESTRICTED NET ASSETS</u> , Beginning of year	<u>37,207,285</u>	<u>35,629,864</u>
<u>UNRESTRICTED NET ASSETS</u> , End of year	<u>\$35,503,921</u>	<u>\$37,207,285</u>

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

THE KROGER CO. FOUNDATION
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED FEBRUARY 1, 2014 AND FEBRUARY 2, 2013

	<u>2014</u>	<u>2013</u>
<u>CASH FLOWS FROM OPERATING ACTIVITIES</u>		
Change in net assets	\$(1,703,364)	\$ 1,577,421
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Net realized and unrealized (gains) losses on investments	1,273,809	(2,449,085)
Changes in assets and liabilities:		
(Increase) Decrease in accounts receivable	(2,989)	33,385
Increase in grants payable	418,526	38,375
Increase (Decrease) in accrued expense	500	(1,830)
Increase (Decrease) in accrued excise tax	(26,439)	27,096
Decrease in deferred excise tax	<u>(27,145)</u>	<u>(9,511)</u>
NET CASH USED IN OPERATING ACTIVITIES	<u>(67,102)</u>	<u>(784,149)</u>
 <u>CASH FLOWS FROM INVESTING ACTIVITIES</u>		
Proceeds from sale of investments	3,750,000	39,325,000
Purchase of investments	<u>(3,588,204)</u>	<u>(38,178,709)</u>
NET CASH PROVIDED BY INVESTING ACTIVITIES	<u>161,796</u>	<u>1,146,291</u>
 NET INCREASE IN CASH AND CASH EQUIVALENTS	94,694	362,142
 <u>CASH AND CASH EQUIVALENTS</u> , Beginning of year	<u>729,587</u>	<u>367,445</u>
 <u>CASH AND CASH EQUIVALENTS</u> , End of year	<u>\$ 824,281</u>	<u>\$ 729,587</u>

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION (Note 6)

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

THE KROGER CO. FOUNDATION

NOTES TO FINANCIAL STATEMENTS

NOTE 1 ACCOUNTING POLICIES

The following is a summary of significant accounting policies followed in the preparation of these financial statements. The financial statements and notes are the representation of the Foundation's management, who is responsible for their integrity and objectivity. The policies conform to accounting principles generally accepted in the United States of America and have been consistently applied.

ORGANIZATION

The Kroger Co. Foundation (the Foundation) is organized as a corporation not-for-profit under the laws of the State of Ohio. The Foundation was established in 1987 to support charitable activities in the communities where The Kroger Co. customers and associates live and work. Grants are awarded to support education, feed the hungry, support breast cancer initiatives and assist local grassroots organizations.

The Foundation ends its fiscal year on the Saturday closest to January 31st.

NET ASSETS

The net assets for 2014 and 2013 are reported as follows:

Unrestricted Net Assets

Unrestricted net assets are assets available for the support of the Foundation operations.

FUNCTIONAL EXPENSES

Program services include expenses which are directly attributable to providing services to the Foundation and designated purposes of donors. Supporting activities include those expenses not directly identifiable with any other specific function, but provide overall support and direction of the Foundation. These expenses are comprised of general and administrative. Directly identifiable expenses are charged to either program services or supporting activities. Expenses related to more than one function are charged to program services or supporting activities on the basis of periodic time and expense studies. Program services and supporting activities for 2014 and 2013 amounted to \$9,532,955 and \$13,297, and \$8,227,975 and \$53,020, respectively.

CASH AND CASH EQUIVALENTS

For purposes of the statements of cash flows, the Foundation considers checking and certificates of deposit as cash equivalents.

INVESTMENTS

Investments are stated at fair value.

DEFERRED EXCISE TAX

The Foundation recognizes a deferred excise tax asset or liability on the difference between reporting methods for financial statement purposes and for tax purposes. The difference results from net unrealized gains or losses recognized for financial statement purposes and not for tax purposes.

RESTRICTED AND UNRESTRICTED REVENUE

Contributions that are restricted by the donor are reported as increases in unrestricted net assets if the restrictions expire in the reporting period in which the revenue is recognized.

USE OF 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 disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expense during the reporting period. Actual results could differ from those estimates.

THE KROGER CO. FOUNDATION

NOTES TO FINANCIAL STATEMENTS

RETROACTIVE RECLASSIFICATION

For comparability purposes, the 2013 figures have been reclassified, where appropriate, to conform with the financial statement presentation used in 2014.

FAIR VALUE MEASUREMENTS

The Fair Value Measurement Topic of the Financial Accounting Standards Board Accounting Standards Codification, establishes a framework for measuring fair value. That framework provides 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 or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy under FASB Accounting Standards Codification are described below:

Level 1

Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Foundation has the ability to access.

Level 2

Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in inactive markets, inputs other than quoted prices that are observable for the asset or liability and inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3

Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Following is a description of the valuation methodology used for assets measured at fair value. There have been no changes in the methodology used at February 1, 2014, and February 2, 2013.

Asset allocation funds are valued at the net asset value (NAV) of shares within the common fund at year end (level 2).

The method described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Foundation believes its valuation method is appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

THE KROGER CO. FOUNDATION

NOTES TO FINANCIAL STATEMENTS

FAIR VALUE MEASUREMENTS (CONT'D)

The following table sets forth by level, within the fair value hierarchy, the Foundation's assets at fair value as of February 1, 2014, and February 2, 2013:

	2014 SIGNIFICANT OTHER OBSERVABLE INPUTS (LEVEL 2)	2013 SIGNIFICANT OTHER OBSERVABLE INPUTS (LEVEL 2)
<u>ASSET ALLOCATION FUNDS</u>		
Equity funds:		
Comerica Equity Allocation Fd Instl CI	\$23,974,338	\$25,004,154
Fixed income funds:		
Comerica Fixed Income Allocation Instl CI	<u>12,378,005</u>	<u>12,783,794</u>
TOTAL	<u>\$36,352,343</u>	<u>\$37,787,948</u>

SUBSEQUENT EVENTS

The Foundation evaluates events and transactions occurring subsequent to the date of the financial statements for matters requiring recognition or disclosure in the financial statements. The accompanying financial statements consider events through May 27, 2014, the date on which the financial statements were available to be issued.

THE KROGER CO. FOUNDATION

NOTES TO FINANCIAL STATEMENTS

NOTE 2 INVESTMENTS

Listed below are the cost basis and fair values of the investments held at February 1, 2014, and February 2, 2013, together with the individual securities which comprise the total portfolio balance.

	<u>COST BASIS</u>	<u>UNREALIZED GAIN</u>	<u>UNREALIZED LOSS</u>	<u>2014 FAIR VALUE</u>
<u>ASSET ALLOCATION FUNDS</u>				
Equity funds:				
Comerica Equity Allocation Fd Instl CI	\$23,617,869	\$ 356,469		\$23,974,338
Fixed income funds:				
Comerica Fixed Income Allocation Instl CI	<u>12,877,011</u>	<u> </u>	\$ <u>499,006</u>	<u>12,378,005</u>
TOTAL	<u>\$36,494,880</u>	<u>\$ 356,469</u>	<u>\$ 499,006</u>	<u>\$36,352,343</u>

	<u>COST BASIS</u>	<u>UNREALIZED GAIN</u>	<u>UNREALIZED LOSS</u>	<u>2013 FAIR VALUE</u>
<u>ASSET ALLOCATION FUNDS</u>				
Equity funds:				
Comerica Equity Allocation Fd Instl CI	\$23,781,993	\$ 1,222,161		\$25,004,154
Fixed income funds:				
Comerica Fixed Income Allocation Instl CI	<u>12,791,234</u>	<u> </u>	\$ <u>7,440</u>	<u>12,783,794</u>
TOTAL	<u>\$36,573,227</u>	<u>\$ 1,222,161</u>	<u>\$ 7,440</u>	<u>\$37,787,948</u>

As a result of the Foundation changing investment advisors during the prior year, the process of accounting for the investment management fees has also changed. The fees are now being netted against investment income. Investment management fees incurred during 2014 amounted to \$82,045, of which the entire amount has been netted against investment income. During 2013 investment management fees incurred amounted to \$68,277, of which \$61,495 was netted against investment income and \$6,782 was charged against operations. Investment management fees are included in professional services on the Statement of Activities.

THE KROGER CO. FOUNDATION

NOTES TO FINANCIAL STATEMENTS

NOTE 3 **EXCISE TAX**

The Foundation is exempt from income tax and is classified as a private foundation under Section 501(c)(3) of the Internal Revenue Code. Contributions to the Foundation qualify as charitable deductions. The federal Return of Private Foundation for the Foundation is no longer subject to federal income tax examination by tax authorities for the years ending prior to 2010. In the normal course of business, the Foundation is subject to examination by various taxing authorities. Although the outcome of tax audits is always uncertain, the Foundation believes that there are no significant unrecognized tax liabilities at February 1, 2014.

As defined by the Internal Revenue Code, the Foundation is subject to a 2 percent federal excise tax on net investment income, including realized gains. At times the Foundation may qualify for a reduced tax of 1 percent. The Foundation qualified for a 1 percent tax in 2014 and 2013.

The amount of federal excise tax expense (benefit) included in the Statements of Activities is composed of the following:

	<u>2014</u>	<u>2013</u>
Current tax	\$36,763	\$46,966
Prior year over accrual	(17,792)	(11,869)
Deferred tax	<u>(27,145)</u>	<u>(9,511)</u>
Total Excise Tax Expense (Benefit)	<u>\$(8,174)</u>	<u>\$25,586</u>

The total amount of penalties recognized in the Statements of Activities amounted to \$208 for 2014. There were no penalties recognized in 2013.

NOTE 4 **RELATED PARTY TRANSACTIONS**

The Foundation's administrative functions are provided in kind by The Kroger Co. All administrative expenses are paid by The Kroger Co. Donated services are not recorded in these financial statements.

NOTE 5 **CONCENTRATION OF CREDIT RISK**

The Foundation's financial instruments that are exposed to concentration of credit risk consists primarily of cash and cash equivalents and investments. The Foundation places its cash and cash equivalents and investments with high credit quality institutions. As of February 1, 2014, the Foundation's cash balances exceeded the Federal Deposit Insurance Corporation (FDIC) limits by \$1,485,813.

NOTE 6 **SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION**

Cash paid during the year for:

	<u>2014</u>	<u>2013</u>
Excise Tax	\$45,411	\$ 8,000

NOTE 7 **RISKS AND UNCERTAINTIES**

The Foundation invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect subsequent statements issued by the Foundation.