

THE CARL B. AND FLORENCE E. KING FOUNDATION
INDEPENDENT AUDITORS' REPORT
AND
FINANCIAL STATEMENTS
DECEMBER 31, 2010 AND 2009

THE CARL B. AND FLORENCE E. KING FOUNDATION

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SMITH, JACKSON, BOYER & BOVARD

A Professional Limited Liability Company
CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

Board of Directors
The Carl B. and Florence E. King Foundation

We have audited the accompanying statements of financial position of The Carl B. and Florence E. King Foundation (the "Foundation") as of December 31, 2010 and 2009, and the related statements of activities, functional expenses and cash flows 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 of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 also 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, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Foundation as of December 31, 2010 and 2009, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.



SMITH, JACKSON, BOYER & BOVARD
A Professional Limited Liability Company

Dallas, Texas
February 24, 2011

THE CARL B. AND FLORENCE E. KING FOUNDATION
STATEMENTS OF FINANCIAL POSITION
December 31, 2010 and 2009

	2010	2009
ASSETS		
Cash and cash equivalents	\$ 114,348	\$ 48,134
Investments at fair value:		
Marketable securities	42,761,024	38,615,252
Oil and gas properties	10,700,000	10,500,000
	53,461,024	49,115,252
Other assets:		
Property and equipment, net	16,350	51,599
Cash value of life insurance policies	5,443,304	5,166,080
Refundable excise and income taxes	-	89
Deposits and prepaid expenses	5,546	9,869
	5,465,200	5,227,637
Total assets	\$ 59,040,572	\$ 54,391,023
LIABILITIES		
Accounts payable and accrued liabilities	\$ 31,340	\$ 17,067
Excise and income tax liabilities	401	-
Deferred excise tax liabilities	193,708	110,768
Grant obligations	651,900	679,042
Employee benefit obligations	663,814	587,060
	1,541,163	1,393,937
COMMITMENTS AND CONTINGENCIES		
NET ASSETS, unrestricted	57,499,409	52,997,086
Total liabilities and net assets	\$ 59,040,572	\$ 54,391,023

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

THE CARL B. AND FLORENCE E. KING FOUNDATION
STATEMENTS OF ACTIVITIES
Years Ended December 31, 2010 and 2009

REVENUES	<u>2010</u>	<u>2009</u>
Interest and dividend income	\$ 1,128,497	\$ 897,297
Royalties and net profit interests from oil and gas properties	2,488,710	1,449,151
Insurance cash value, net of premiums	277,224	272,515
Other income	2,786	13,728
	<u>3,897,217</u>	<u>2,632,691</u>
Realized gains (losses) on marketable securities	172,630	(1,263,495)
Unrealized gains (losses) on investments	3,910,221	9,363,102
	<u>4,082,851</u>	<u>8,099,607</u>
Total revenues	7,980,068	10,732,298
OPERATING EXPENSES		
Investment expenses	559,590	423,464
Program expenses	654,246	621,719
Provision for excise and income taxes	123,077	140,435
Total operating expenses	<u>1,336,913</u>	<u>1,185,618</u>
DISTRIBUTIONS		
Grants	2,058,247	1,494,827
Scholarships	24,000	45,000
Total distributions	<u>2,082,247</u>	<u>1,539,827</u>
Increase (decrease) in net assets before extraordinary item	4,560,908	8,006,853
EXTRAORDINARY ITEM		
Costs related to litigation activities	(58,585)	(39,247)
Increase (decrease) in net assets	4,502,323	7,967,606
NET ASSETS, beginning of year - unrestricted	<u>52,997,086</u>	<u>45,029,480</u>
NET ASSETS, end of year - unrestricted	<u>\$ 57,499,409</u>	<u>\$ 52,997,086</u>

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

THE CARL B. AND FLORENCE E. KING FOUNDATION
STATEMENTS OF FUNCTIONAL EXPENSES
Year Ended December 31, 2010
(With Comparative Totals for Year Ended December 31, 2009)

	Investment Expenses	Program Expenses	Total 2010	Total 2009
MARKETABLE SECURITIES EXPENSES				
Management and advisor fees	\$ 46,733	\$ -	\$ 46,733	\$ 42,715
	46,733	-	46,733	42,715
OIL AND GAS EXPENSES				
Operating expenses and production taxes	403,532	-	403,532	275,948
Ad valorem taxes	51,793	-	51,793	49,796
	455,325	-	455,325	325,744
HUMAN RESOURCE EXPENSES				
Salaries	24,130	275,852	299,982	299,982
Payroll taxes	1,752	20,575	22,327	22,162
Employee insurance	2,990	34,387	37,377	34,804
Employee medical reimbursements	404	4,644	5,048	3,728
SEP-IRA contribution	2,160	24,838	26,998	26,998
Retirement costs	7,580	87,174	94,754	106,881
Other life insurance	274	3,156	3,430	3,650
Accounting and actuarial services	100	1,150	1,250	750
Computer services	1,356	15,593	16,949	17,645
Conferences and meetings	398	4,572	4,970	2,207
Travel and entertainment	3,029	34,830	37,859	18,790
	44,173	506,771	550,944	537,597
OFFICE EXPENSES				
Depreciation	2,889	33,227	36,116	13,899
Dues	1,104	12,695	13,799	13,874
Office equipment and supplies	1,431	16,455	17,886	17,087
Office rent	3,584	41,213	44,797	44,810
Printing expenses	94	1,080	1,174	522
Publications and subscriptions	30	344	374	560
Repairs and maintenance	26	304	330	256
Storage fees	143	1,648	1,791	1,749
Taxes-personal property	90	1,040	1,130	1,043
Telephone	561	6,447	7,008	8,355
	9,952	114,453	124,405	102,155
OTHER EXPENSES				
Bank and credit card fees	535	-	535	836
Insurance	1,285	14,779	16,064	16,573
Legal fees	223	2,565	2,788	112
Audit and tax fees	1,316	15,138	16,454	16,001
Miscellaneous expenses	48	540	588	3,450
	3,407	33,022	36,429	36,972
	<u>\$ 559,590</u>	<u>\$ 654,246</u>	<u>\$ 1,213,836</u>	<u>\$ 1,045,183</u>

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

THE CARL B. AND FLORENCE E. KING FOUNDATION
STATEMENTS OF CASH FLOWS
Years Ended December 31, 2010 and 2009

	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Increase (decrease) in net assets	\$ 4,502,323	\$ 7,967,606
Adjustments to reconcile increase (decrease) in net assets to net cash provided by operating activities:		
Depreciation of property and equipment	36,116	13,899
Realized losses (gains) on marketable securities	(172,630)	1,263,495
Unrealized losses (gains) on investments	(3,910,221)	(9,363,102)
Increase in cash value of life insurance policies	(277,224)	(272,515)
Deferred excise tax	82,940	110,768
(Increase) decrease in:		
Refundable excise and income taxes	89	13,276
Deposits and prepaid expenses	4,323	(704)
Increase (decrease) in:		
Accounts payable and accrued liabilities	14,273	(6,976)
Excise and income tax liabilities	401	-
Grant obligations	(27,142)	(283,731)
Employee benefit obligations	76,754	88,881
Net cash provided by (used in) operating activities	330,002	(469,103)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of marketable securities	(5,743,600)	(6,165,224)
Proceeds from sale of marketable securities	5,480,679	6,369,543
Purchase of property and equipment	(867)	(8,792)
Net cash provided by (used in) investing activities	(263,788)	195,527
NET INCREASE (DECREASE) IN CASH FLOWS	66,214	(273,576)
CASH AND CASH EQUIVALENTS, beginning of year	48,134	321,710
CASH AND CASH EQUIVALENTS, end of year	\$ 114,348	\$ 48,134
SUPPLEMENTAL CASH FLOW INFORMATION		
Federal excise and income tax paid	\$ 39,647	\$ 16,391

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

THE CARL B. AND FLORENCE E. KING FOUNDATION
NOTES TO FINANCIAL STATEMENTS
December 31, 2010 and 2009

1 - SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The Carl B. and Florence E. King Foundation (the "Foundation") was incorporated in 1966 as a nonprofit corporation for the purpose of supporting charitable and educational undertakings. The Foundation invests its funds and uses the return from the investments to make grants and scholarships to various charitable organizations and individual students. Carl B. King, Florence E. King, and their daughter, Dorothy King, provided substantially all of the donations to the Foundation through their bequests. All bequests to the Foundation were unrestricted.

Basis of Accounting and Presentation

The financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America, whereby revenues are recorded when earned and expenses are recorded when incurred.

Cash and Cash Equivalents

The Foundation considers all highly liquid investments having original maturities of three months or less to be cash equivalents. The carrying amounts of cash and cash equivalents reported in the statements of financial position approximate fair values because of the short maturities of those instruments.

Investments in Marketable Securities

Investments in marketable securities consist of institutional mutual funds that are valued at their fair values in the statements of financial position. Fair value of institutional mutual funds is determined by the fund manager. Unrealized gains and losses are determined by comparison of specific costs of acquisition to the market value at the statement of financial position date. Cost of investments and net realized gains or losses from investment transactions are determined on the specific identification method. Long-term capital gain distributions from mutual funds are included in interest and dividend income in the statements of activities, which amounted to \$102,551 and \$4,952 for the years ended December 31, 2010 and 2009, respectively.

Investments are made according to policies adopted by the Foundation's board of directors. These guidelines provide for an investment allocation between equities and fixed income securities held by the institutional mutual funds. Performance of the institutional mutual funds is measured against appropriate indices.

Investments in Oil and Gas Properties

Investments in oil and gas properties consist of royalty and net profit interests in various oil and gas producing properties, and a working interest in a gas plant.

Investments in oil and gas properties are valued at their fair values in the statements of financial position. Fair value in 2010 and 2009 is based on an independent appraisal. Unrealized gains and losses are determined by comparison of the cost basis in the oil and gas properties to the appraisal value at the statement of financial position date.

THE CARL B. AND FLORENCE E. KING FOUNDATION
NOTES TO FINANCIAL STATEMENTS
December 31, 2010 and 2009

Royalty, net profit, and working interest revenues are collected and held in a custodial investment account administered by a financial institution. Revenues are recognized as earned by the financial institution on a monthly basis.

Property and Equipment

Property and equipment is recorded at cost less accumulated depreciation. Depreciation is provided for using the straight-line method over the estimated useful lives of the assets. The cost of maintenance and repair is charged to expense as incurred, major renewals and betterments are capitalized.

Grants

Grant contracts are expensed when the unconditional promise to give is approved by the board of directors. Conditional promises to give, consisting primarily of grant contracts with matching requirements or construction starts, are recognized as expense in the period in which the grantee meets the terms of the condition.

Functional Expenses

Operating expenses are charged to functional categories of program expenses and investment expenses based on specific identification or allocated based on employee activities and periodic time studies.

Federal Excise and Income Taxes

The Foundation qualifies as a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code and, accordingly, is not subject to federal income tax. As a private foundation under Section 509, the Foundation is subject to federal excise tax and unrelated business income tax. The Internal Revenue Code imposes an excise tax on private foundations equal to 2% of net investment income. The excise tax rate is reduced to 1% for foundations that meet certain distribution requirements.

Deferred income taxes are recognized, based on the statutory excise tax rate, when assets and liabilities have different values for financial statement and tax reporting purposes.

The Foundation has evaluated all current and prior year tax positions and has determined there are no uncertain tax positions that require recognition and disclosure in the financial statements. Additionally, the Foundation does not have any outstanding interests or penalties, and none have been recorded in the statement of activities for the years ended December 31, 2010 and 2009.

Use of Estimates

The preparation of these financial statements 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 revenues and expenses during the reporting period. Actual results could differ from these estimates.

Credit and Market Risk

Financial instruments that potentially subject the Foundation to concentrations of credit and market risk consist principally of cash and cash equivalents and investments. The Foundation maintains its

THE CARL B. AND FLORENCE E. KING FOUNDATION
NOTES TO FINANCIAL STATEMENTS
December 31, 2010 and 2009

cash and cash equivalents with financial institutions, which at times exceeds federally insured limits. The Foundation has not experienced any losses on its cash accounts or cash equivalent accounts. Investments in marketable securities are concentrated in institutional mutual funds managed by one financial institution. However, the institutional mutual fund portfolio is diversified among many investment sectors. Investments in oil and gas properties are subject to volatile oil and gas prices and production declines.

2 - INVESTMENTS

Investments in marketable securities at December 31, 2010 and 2009, consist of institutional mutual funds. The fair value of institutional mutual funds at December 31, 2010 and 2009, was \$42,761,024 and \$38,615,252, respectively. The cost of institutional mutual funds at December 31, 2010 and 2009, was \$44,012,409 and \$43,576,856, respectively.

Investments in oil and gas properties at December 31, 2010 and 2009, consist of net profits interests and royalty interests in various oil and gas producing properties, and a working interest in a gas plant. The fair value of oil and gas properties at December 31, 2010 and 2009, was \$10,700,000 and \$10,500,000, respectively. The cost of oil and gas properties at December 31, 2010 and 2009, was fully depleted.

Unrealized gains (losses) arising from the valuation of investments for the years ended December 31, 2010 and 2009, consisted of the following:

	<u>2010</u>	<u>2009</u>
Marketable securities	\$ 3,710,221	\$ 8,263,102
Oil and gas properties	200,000	1,100,000
	<u>\$ 3,910,221</u>	<u>\$ 9,363,102</u>

3 - PROPERTY AND EQUIPMENT

Property and equipment at December 31, 2010 and 2009, consisted of the following:

	<u>2010</u>	<u>2009</u>
Office furniture and equipment	\$ 26,737	\$ 105,903
Computer equipment	50,574	66,051
Leasehold improvements	35,468	35,468
	<u>112,779</u>	<u>207,422</u>
Less accumulated depreciation	(96,429)	(155,823)
	<u>\$ 16,350</u>	<u>\$ 51,599</u>

Depreciation of property and equipment was \$36,116 and \$13,899 for the years ended December 31, 2010 and 2009, respectively.

THE CARL B. AND FLORENCE E. KING FOUNDATION
NOTES TO FINANCIAL STATEMENTS
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4 - EMPLOYEE BENEFITS

Qualified Contribution Plans

The Foundation has a SEP-IRA plan covering all of the Foundation's employees. The Foundation contributed \$26,998 in 2010 and 2009, based on 9% of the Employees' compensation.

The Foundation's employees may also elect to participate in a separate 403(b)(7) salary deferral plan. No contributions were made by the Foundation under this plan.

Nonqualified Retirement Benefit Agreements

A Foundation employee executed an employment contract on February 27, 2004, that includes a non-qualified retirement benefit upon retirement based upon 75% of a fixed salary. Additionally, effective January 1, 2004, a previously retired employee, who was receiving a monthly retirement benefit, agreed to receive a reduced monthly benefit of \$1,500 over the remaining life of the retiree and \$1,250 over the life of the surviving spouse.

The actuarial present value of the unfunded benefit obligations was accrued in the statements of financial position at December 31, 2010 and 2009, in the amount of \$663,814 and \$587,060, respectively. Retirement cost was recognized in the statements of activities for the years ended December 31, 2010 and 2009, in the amount of \$94,754 and \$106,881, respectively. The weighted-average discount rate used in determining the actuarial present value of the unfunded benefit obligations was 4.91% in 2010 and 5.5% in 2009.

5 - OPERATING LEASE COMMITMENTS

The Foundation leases real property and equipment under noncancelable leases that expire through 2013. The following is a schedule of future minimum lease payments under noncancelable operating leases:

<u>Year ended December 31,</u>	
2011	\$ 34,536
2012	7,645
2013	<u>7,645</u>
Total	<u>\$ 49,826</u>

Rental expense was \$54,941 and \$52,913 for the years ended December 31, 2010 and 2009, respectively.

6 -GRANT OBLIGATIONS

At December 31, 2010, the Foundation has approved unconditional grant contracts for payment to various organizations in the amount of \$651,900, which are restricted upon terms as specified in the grant contracts. Total future grant payments of \$651,900 are payable in 2011.

At December 31, 2010, the Foundation has approved conditional grant contracts in the amount of \$37,000, which expire in 2011.

THE CARL B. AND FLORENCE E. KING FOUNDATION
NOTES TO FINANCIAL STATEMENTS
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7 - FEDERAL EXCISE AND INCOME TAXES

The components of the provision for excise and income taxes for the years ended December 31, 2010 and 2009, were as follows:

	<u>2010</u>	<u>2009</u>
Federal excise tax	\$ 31,811	\$ 18,630
Unrelated business income tax	8,326	11,037
Deferred excise tax	<u>82,940</u>	<u>110,768</u>
	<u>\$ 123,077</u>	<u>\$ 140,435</u>

The Foundation is exempt from federal income taxes under Section 501(a) of the Internal Revenue Code, as an organization described in Section 501(c)(3). Accordingly, the Foundation is not subject to federal income tax, except to the extent that it has unrelated business income relating to certain oil and gas investments.

The Foundation is classified as a private foundation under Section 509 and, as such, is subject to a federal excise tax of 2% on net investment income, unless certain conditions are met, in which case the federal excise tax can be reduced to 1%. The Foundation recorded a provision for excise tax in 2010 and 2009 at the 1% excise tax rate.

Deferred excise tax is provided for on the unrealized increase or decrease in the fair value of the Foundation's investment assets at the 2% excise tax rate. The components of the net deferred tax assets and liabilities at December 31, 2010 and 2009, are as follows:

	<u>2010</u>	<u>2009</u>
Investment in marketable securities	\$ 20,292	\$ 99,232
Investment in oil and gas properties	<u>(214,000)</u>	<u>(210,000)</u>
Net deferred tax assets (liabilities)	<u>\$ (193,708)</u>	<u>\$ (110,768)</u>

The Foundation files U.S. federal tax returns. The tax years after 2007 remain open and subject to examination by the Internal Revenue Service.

8 - FAIR VALUE MEASUREMENTS

Accounting standards requires disclosures that categorize assets and liabilities measured at fair value into one of three different levels depending on the observability of the inputs employed in the measurement. The three levels of inputs that may be used to measure fair value are as follows:

Level 1 - Valuations based on quoted prices in active markets for identical assets or liabilities. The Foundation's Level 1 assets consist of money market fund deposits and institutional mutual funds, which are traded in an active market with sufficient volume and frequency of transactions.

Level 2 - Valuations based on quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable data for substantially the full term of the assets or liabilities. The Foundation's Level 2 assets consist of cash value of life insurance policies, which can be corroborated by policy data over the term of the policy contract.

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Level 3 - Valuations based on unobservable inputs to the valuation methodology. The Foundation's Level 3 assets consist of royalty, net profit, and working interests in producing oil and gas properties, whose valuation was determined by an independent appraisal using the discounted net cash flow technique. The Foundation's Level 3 liabilities consist of employee benefit obligations, whose valuation was determined by an independent actuarial firm using the present value technique of projected benefit obligations. These estimates of valuation are subjective in nature and involve uncertainties and matters of significant judgment and therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

The carrying amount for certain assets and liabilities approximates fair value, because of the short-term maturity of these assets and liabilities, which include cash deposits, refundable taxes, accounts payable, accrued liabilities, tax liabilities, and grant obligations.

The following table presents the Foundation's assets and liabilities measured at fair value on a recurring annual basis as of December 31, 2010.

	Quoted Prices In Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
ASSETS			
Cash equivalents			
Money market fund deposits	\$ 88,736	\$ -	\$ -
Investments in marketable securities			
Institutional mutual funds	42,761,024	-	-
Investments in oil and gas properties			
Royalty and net profit interests	-	-	10,700,000
Cash value of life insurance policies	-	5,443,304	-
Assets measured at fair value	<u>\$ 42,849,760</u>	<u>\$ 5,443,304</u>	<u>\$ 10,700,000</u>
LIABILITIES			
Employee benefit obligations	\$ -	\$ -	\$ 663,814
Liabilities measured at fair value	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 663,814</u>

THE CARL B. AND FLORENCE E. KING FOUNDATION
NOTES TO FINANCIAL STATEMENTS
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The following table presents a reconciliation of the beginning and ending balances of the Foundation's assets and liabilities that were recorded at fair value on a recurring annual basis using significant unobservable inputs (Level 3) during the year ended December 31, 2010:

	Royalty and Net Profit Interests	Employee Benefit Obligations
Beginning balance at fair value	\$ 10,500,000	\$ 587,060
Change in unrealized gains (losses)	200,000	-
Retirement costs - service and interest	-	94,754
Benefits paid	-	(18,000)
Ending balance at fair value	<u>\$ 10,700,000</u>	<u>\$ 663,814</u>

The following table presents the Foundation's assets and liabilities measured at fair value on a recurring annual basis as of December 31, 2009:

	Quoted Prices In Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
ASSETS			
Cash equivalents			
Money market fund deposits	\$ 33,152	\$ -	\$ -
Investments in marketable securities			
Institutional mutual funds	38,615,252	-	-
Investments in oil and gas properties			
Royalty and net profit interests	-	-	10,500,000
Cash value of life insurance policies	-	5,166,080	-
Assets measured at fair value	<u>\$ 38,648,404</u>	<u>\$ 5,166,080</u>	<u>\$ 10,500,000</u>
LIABILITIES			
Employee benefit obligations	\$ -	\$ -	\$ 587,060
Liabilities measured at fair value	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 587,060</u>

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The following table presents a reconciliation of the beginning and ending balances of the Foundation's assets and liabilities that were recorded at fair value on a recurring annual basis using significant unobservable inputs (Level 3) during the year ended December 31, 2009:

	Royalty and Net Profit Interests	Employee Benefit Obligations
Beginning balance at fair value	\$ 9,400,000	\$ 498,179
Change in unrealized gains (losses)	1,100,000	-
Retirement costs - service and interest	-	106,881
Benefits paid	-	(18,000)
Ending balance at fair value	<u>\$ 10,500,000</u>	<u>\$ 587,060</u>

Assets Measured at Fair Value on a Non-Recurring Basis – The Foundation assesses potential impairments to long-lived assets, including property and equipment, whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. For these assets, measurement at fair value in periods subsequent to their initial recognition is applicable if one or more is determined to be impaired. During the years ended December 31, 2010 and 2009, the Foundation had no impairments related to these assets.

9 - LITIGATION AND EXTRAORDINARY ITEM

Travis County Lawsuit

The Foundation was a co-plaintiff in a lawsuit styled *Attorney General Greg Abbott, on behalf of the public interest in charity, and The Carl B. and Florence E. King Foundation v. Carl L. Yeckel, et al.*

The defendants included Carl L. Yeckel ("Yeckel"), former officer and director; Thomas W. Vett ("Vett"), former officer; and four former Foundation directors. The case was tried to a jury before Probate Court No. 1 in Travis County, Texas, from May 27, 2004 through June 14, 2004. All defendants except Yeckel and Vett settled before the conclusion of the trial.

The issues in the litigation included payment of excessive compensation to Yeckel and Vett, Yeckel and Vett's use of Foundation credit cards for personal expenses, and the validity of purported retirement agreements that Yeckel and Vett contended entitled them to 75% of their last year's salary for life, with one-half of those amounts to their surviving spouses for life. Yeckel and Vett pursued counterclaims against the Foundation under the purported agreements.

After a jury verdict in favor of the Foundation and the Attorney General, and post-trial motions, the trial court awarded the Foundation more than \$7 million in actual damages and \$14 million in exemplary damages against the two defendants, and also declared void the purported retirement agreements through which Yeckel and Vett had asserted counterclaims against the Foundation. The Foundation recognized the elimination of the outstanding employee benefit obligations under these agreements in 2004 as an extraordinary gain of \$10.4 million. The case became final in 2004 as to Vett. The Foundation's judgment against Vett, including actual and punitive damages, totals \$5.8 million plus interest. Yeckel appealed the judgment against him in 2004.

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Yeckel's appeal of the judgment (the "State Appeal") was orally argued before the Third District Court of Appeals in Austin on January 25, 2006. The Court of Appeals ruled on June 4, 2009, reversing the award of exemplary damages against Yeckel on technical grounds, but otherwise affirming the judgment for the Foundation, including the award of actual damages and the dismissal of Yeckel's counterclaim. Yeckel appealed the Austin appellate court's decision to the Texas Supreme Court in 2009, but the latter court denied his petition for review on January 8, 2010. Yeckel did not appeal the case further, so the Foundation's remaining judgment against Yeckel of \$5.3 million, plus interest, became final in April 2010, when the deadline for appeal to the United States Supreme Court expired.

In August 2005, while the State Appeal was pending, Yeckel filed for bankruptcy. The bankruptcy court allowed the State Appeal to continue during the bankruptcy, but some aspects of the bankruptcy were delayed until the State Appeal concluded in 2010. The Yeckel bankruptcy case remains pending, but there are currently no claims against the Foundation.

The Foundation is actively involved as a creditor in the Yeckel bankruptcy and is a plaintiff in related adversary proceedings against Yeckel and others in the bankruptcy court. In addition, the Foundation has agreed to advance certain legal fees and expenses to the Chapter 7 Trustee in the Yeckel bankruptcy.

Due to the nature of litigation and appeals and the inherent uncertainties associated with both, the Foundation cannot accurately predict the outcome of this case in the federal courts. The Foundation is determined to collect the Travis County judgment and the Texas Attorney General's office is working together with the Foundation in the bankruptcy proceedings toward this end.

Extraordinary Item

The costs associated with these litigation activities have been recorded in the accompanying statements of activities as an extraordinary item. Due to uncertainty of collection related to the Travis County jury verdict against Yeckel and Vett in the amount of \$11,091,576, these claims have not been recorded in the accompanying financial statements.

10 - SUBSEQUENT EVENTS

The Foundation has evaluated all subsequent events and transactions through February 24, 2011, the date the financial statements were available to be issued. The Foundation has determined there are no subsequent events that require recognition or disclosure in the financial statements.