# THE ELIZABETH HOSPICE, INC.
Escondido, California

# CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2017 and 2016

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Crowe Horwath.

Crowe Horwath LLP
Independent Member Crowe Horwath International

INDEPENDENT AUDITOR'S REPORT

Board of Directors
The Elizabeth Hospice, Inc.
Escondido, California

**Report on the Financial Statements**

We have audited the accompanying financial statements of The Elizabeth Hospice, Inc., which comprise the balance sheet as of June 30, 2017, and the related statements of operations and changes in net assets and cash flows for the year 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 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 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.

(Continued)

**Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Elizabeth Hospice, Inc. as of June 30, 2017, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

**Other Matter**

The consolidated financial statements of The Elizabeth Hospice, Inc. and Elizabeth Hospice Foundation as of June 30, 2016, were audited by other auditors whose report dated September 26, 2016, expressed an unmodified opinion on those statements.

Crowe Horwath LLP

Crowe Horwath LLP

South Bend, Indiana
September 26, 2017

THE ELIZABETH HOSPICE, INC.
CONSOLIDATED BALANCE SHEETS
June 30, 2017 and 2016

| | 2017 | 2016 |
|---|---|---|
| **ASSETS** | | |
| Current assets | | |
| Cash and cash equivalents | $ 3,447,790 | $ 3,126,839 |
| Patient accounts receivable, net | 3,522,167 | 3,618,500 |
| Pledges receivable | - | 560,000 |
| Prepaid expenses and other | 418,246 | 1,150,492 |
| Total current assets | 7,388,203 | 8,455,831 |
| Property and equipment, net | 3,318,171 | 3,454,973 |
| Investments | 10,862,615 | 8,184,290 |
| | $ 21,568,989 | $ 20,095,094 |
| **LIABILITIES AND NET ASSETS** | | |
| Current liabilities | | |
| Accounts payable | $ 947,788 | $ 1,789,691 |
| Accrued expenses | 2,480,609 | 2,213,478 |
| Total current liabilities | 3,428,397 | 4,003,169 |
| Net assets | | |
| Unrestricted | | |
| Undesignated | 10,418,664 | 13,289,412 |
| Board designated | 4,663,087 | - |
| Total unrestricted net assets | 15,081,751 | 13,289,412 |
| Temporarily restricted | 478,514 | 222,186 |
| Permanently restricted | 2,580,327 | 2,580,327 |
| Total net assets | 18,140,592 | 16,091,925 |
| | $ 21,568,989 | $ 20,095,094 |

See accompanying notes to consolidated financial statements.

THE ELIZABETH HOSPICE, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS
Years ended June 30, 2017 and 2016

| | 2017 | 2016 |
|---|---|---|
| **Unrestricted net assets** | | |
| Operating revenue | | |
| Net patient service revenue | $ 31,203,982 | $ 33,742,250 |
| Contributions and fundraising | 2,005,592 | 1,086,183 |
| Special events | 134,376 | 58,247 |
| Interest and dividends, net of fees | 89,658 | 91,962 |
| Realized gains on investments | 70,981 | 1,022,863 |
| Other revenue | 124,372 | 55,079 |
| Net assets released from restriction | 98,612 | 43,181 |
| Total operating revenue | 33,727,573 | 36,099,765 |
| Operating expenses | | |
| Direct patient care | 17,993,535 | 18,303,966 |
| Indirect patient care | 7,385,723 | 10,150,589 |
| Community outreach | 1,166,024 | 719,140 |
| Management and general | 5,358,556 | 5,617,006 |
| Fundraising | 517,780 | 601,740 |
| Total operating expenses | 32,421,618 | 35,392,441 |
| Change in unrestricted net assets from operations | 1,305,955 | 707,324 |
| Nonoperating revenues | | |
| Unrealized gains (losses) on investments | 486,384 | (1,131,092) |
| Change in unrestricted net assets | 1,792,339 | (423,768) |
| **Temporarily restricted net assets** | | |
| Contributions | 107,217 | 98,795 |
| Interest and dividends, net of fees | 35,272 | 23,652 |
| Net realized and unrealized gains (losses) on investments | 212,451 | (28,376) |
| Net assets released from restriction | (98,612) | (43,181) |
| Change in temporarily restricted net assets | 256,328 | 50,890 |
| **Change in net assets** | 2,048,667 | (372,878) |
| Net assets at beginning of year | 16,091,925 | 16,464,803 |
| **Net assets at end of year** | $ 18,140,592 | $ 16,091,925 |

See accompanying notes to consolidated financial statements.

THE ELIZABETH HOSPICE, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended June 30, 2017 and 2016

| | 2017 | 2016 |
|---|---|---|
| **Cash flows from operating activities** | | |
| Change in net assets | $ 2,048,667 | $ (372,878) |
| Adjustments to reconcile change in net assets to net cash from operating activities: | | |
| Depreciation | 334,712 | 346,587 |
| Provision for uncollectible accounts | 51,601 | 395,338 |
| Net realized and unrealized (gains) losses on investments | (769,816) | 136,605 |
| Changes in assets and liabilities | | |
| Patient accounts receivable | 44,732 | 1,755,956 |
| Pledges receivable | 560,000 | (560,000) |
| Prepaid expenses and other | (192,312) | (45,809) |
| Accounts payable | 82,655 | (523,794) |
| Accrued expenses | 267,131 | (679,711) |
| Net cash from operating activities | 2,427,370 | 452,294 |
| **Cash flows from investing activities** | | |
| Purchase of property and equipment | (197,910) | (256,873) |
| Proceeds from sales of investments | 5,502,143 | 1,385,891 |
| Purchases of investments | (7,410,652) | - |
| Net cash from investing activities | (2,106,419) | 1,129,018 |
| Net change in cash and cash equivalents | 320,951 | 1,581,312 |
| Cash and cash equivalents at beginning of year | 3,126,839 | 1,545,527 |
| **Cash and cash equivalents at end of year** | $ 3,447,790 | $ 3,126,839 |

See accompanying notes to consolidated financial statements.

**NOTE 1 - NATURE OF ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES**

Organization: The Elizabeth Hospice, Inc. (the "Hospice") is organized under the charitable public benefit nonprofit corporate laws of the state of California. The Hospice's primary purposes are to provide end-of-life care services to terminally ill patients, contribute to the sense of well-being of terminally ill patients and their families, and to train professionals and volunteers in the hospice concept.

Elizabeth Hospice Foundation (the "Foundation"), organized under the charitable public benefit nonprofit corporate laws of the state of California, was formed as a primary fundraising vehicle for the Hospice. Effective July 1, 2016, the assets and liabilities of the Foundation were transferred to the Hospice, and the Foundation was discontinued as a separate organization.

Basis of Consolidation: The 2016 consolidated financial statements include the accounts of the Hospice and the Foundation. All significant inter-organizational accounts and transactions between the Hospice and the Foundation have been eliminated in consolidation. Collectively the entities are referred to as the "Organization".

Basis of Accounting: The consolidated financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP").

Use of Estimates: The preparation of consolidated financial statements in conformity with U.S. GAAP 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 consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Financial Statement Presentation: The consolidated financial statements report the changes in and totals of each net asset class based on the existence of donor restrictions, as applicable. Net assets are classified as unrestricted, temporarily restricted, or permanently restricted and are detailed as follows:

> Unrestricted net assets represent the part of the net assets that is neither permanently restricted nor temporarily restricted by donor-imposed stipulations. The unrestricted net assets are comprised of Board designated and unrestricted amounts. As of June 30, 2017, board designated net assets consist of $4,663,087 designated for an endowment created during the year ended June 30, 2017.
>
> Temporarily restricted net assets represent the part of the net assets resulting from contributions and other inflows of assets whose use is limited by donor-imposed stipulations that either expire by the passage of time or by actions of the Organization. As of June 30, 2017 and 2016, temporarily restricted net assets consisted of donor restricted funds designated for various programs.
>
> Permanently restricted net assets represent the part of the net assets resulting from contributions and other inflows of assets whose use is limited by donor-imposed stipulations that neither expire by passage of time nor can be fulfilled or otherwise removed by actions of the Organization.

Cash and Cash Equivalents: Cash and cash equivalents consist of bank deposits in accounts that are federally insured up to $250,000. Additionally, for purposes of the consolidated statements of cash flows, the Organization considers all highly liquid investments of operating cash purchased with an original maturity of three months or less to be cash equivalents.

(Continued)

**NOTE 1 - NATURE OF ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Patient Accounts Receivable: The patient accounts receivable balance represents the unpaid amounts billed to patients and third-party payors. Contractual adjustments, discounts, and an allowance for uncollectible accounts are recorded to report receivables for patient care services at their net realizable value. Past due receivables are determined based on contractual terms. The Organization does not accrue interest on any of its accounts receivables.

Allowance for Uncollectible Accounts: The allowance for uncollectible accounts is determined by management based upon the Organization's historical losses, specific patient circumstances, and general economic conditions. Periodically, management reviews patient accounts receivable and records an allowance based on current circumstances, and charges off the receivable against the allowance when all attempts to collect the receivable are deemed to have failed in accordance with the internal collection policy. Management believes the allowances of approximately $229,231 and $309,903 as of June 30, 2017 and 2016, respectively, are adequate to cover potential losses from uncollectible accounts.

Pledges Receivable: Pledges receivable represent the remaining balance of unconditional promises to give that have not yet been paid. Pledges that are expected to be collected within one year or less are recorded at net realizable value. Pledges that are expected to be collected beyond one year are recorded at the present value of their estimated future cash flows. The pledges have been discounted using a rate commensurate with risk applicable during the time the pledge was made. Amortization of the pledge discounts is recognized as contribution revenue each year until the pledge is paid in full. As of June 30, 2017 and 2016, all pledges receivable are classified as current assets. Conditional promises to give are recognized only when the conditions on which they depend are substantially met and the promises become unconditional.

Investments: All investments are valued at their fair values in the balance sheets. Unrealized gains and losses are included in the change in net assets. See Note 3 for additional information on the nature of the Organization's investments.

Property and Equipment: Property and equipment are stated at cost or, if donated to the Organization, at their fair value on the date of the gift. Additions and improvements over $2,000 are capitalized; expenditures for routine maintenance are charged to operations. Depreciation is computed over the estimated useful lives of the various classes of assets using the straight-line method.

Gifts of long-lived assets such as land, buildings, and equipment are reported as unrestricted support unless explicit donor stipulations specify how the donated assets are to be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash and other assets that must be used to acquire long-lived assets are reported as temporarily restricted support. Absent explicit donor stipulations about how long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

Impairment of Long-Lived Assets: On an ongoing basis, the Organization reviews long-lived assets for impairment whenever events or circumstances indicate that the carrying amounts may be overstated. The Organization recognizes impairment losses if the undiscounted cash flows expected to be generated by the asset are less than the carrying value of the related asset. The impairment loss adjusts the assets to fair value. As of June 30, 2017 and 2016, management believes that no assets were impaired.

Net Patient Service Revenue: Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. For the years ended June 30, 2017 and 2016, approximately 97% of the Organization's net patient service revenue was derived from the Medicare and Medicaid programs.

(Continued)

**NOTE 1 - NATURE OF ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Provisions for estimated third-party payor settlements have been made in the consolidated financial statements for estimated contractual adjustments, representing the difference between the standard charges for services and estimated total payments to be received from third-party payors. These estimates are adjusted in future periods as final settlements are determined.

The Organization, like other health care providers, may be subject to investigations, regulatory action, lawsuits, and claims arising out of the conduct of its business, including the interpretation of laws and regulations governing the Medicare and Medicaid programs and other third-party payor agreements. Management intends to fully cooperate with any governmental agencies in requests for information. Noncompliance with laws and regulations can make the Organization subject to regulatory action, including fines, penalties, and exclusion from the Medicare and Medicaid programs.

Hospice organizations are subject to two specific payment limit caps under the Medicare program. One limit relates to inpatient care days that exceed 20% of the total days of hospice care provided for the year. The second limit relates to an aggregate Medicare reimbursement cap amount. The Organization did not exceed either of the Medicare cap limitations for the years ended June 30, 2017 and 2016.

Charity Care: The Organization determines each patient's ability to pay during the admission process. When a patient meets certain criteria, part or all of the patient's charges are deemed charity care and are not billed for collection. Because the Organization does not pursue collection of amounts determined to qualify as charity care, those amounts are excluded from net patient service revenue. The cost of charity care provided was approximately $225,000 and $80,000 for the years ended June 30, 2017 and 2016, respectively. This cost estimate was based on the Organization-wide cost to charge ratio.

Contributions: Contributions received and unconditional promises to give are recorded as unrestricted, temporarily restricted, or permanently restricted revenue depending on the existence of donor restrictions and the nature of such restrictions, if they exist.

When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statements of operations and changes in net assets as net assets released from restriction.

If a restriction is fulfilled in the same accounting period in which the contribution is received, the contribution is reported as unrestricted.

Functional Allocation of Expenses: The costs of providing various programs and other activities have been summarized on a functional basis in the consolidated statements of operations and changes in net assets. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

Change in Unrestricted Net Assets from Operations: The consolidated statements of operations and changes in net assets include changes in unrestricted net assets from operations. Changes in unrestricted net assets which are excluded from changes in unrestricted net assets from operations, consistent with industry practice, include unrealized gains (losses) on investments.

Income Taxes: The Organization is exempt from income taxes on income from related activities under Section 501(c)(3) of the U.S. Internal Revenue Code and corresponding state tax law. Accordingly, no provision has been made for federal or state income taxes.

(Continued)

**NOTE 1 - NATURE OF ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES** (Continued)

U.S. GAAP requires that a tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded.

Due to its tax-exempt status, the Organization is not generally subject to U.S. federal income tax or state income tax. The Organization's Form 990 has not been subject to examination by the Internal Revenue Service or the state of California for the last three years. The Organization does not expect the total amount of unrecognized tax benefits to significantly change in the next 12 months. The Organization recognizes interest and/or penalties related to income tax matters in income tax expense. The Organization did not have any amounts accrued for interest and penalties at June 30, 2017 and 2016.

Reclassifications: Certain reclassifications have been made to present last year's consolidated financial statements on a basis comparable to the current year's financial statements. These reclassifications had no effect on total net assets or the change in net assets.

Subsequent Events: Management has performed an analysis of the activities and transactions subsequent to June 30, 2017 to determine the need for any adjustments to and/or disclosures within the consolidated financial statements for the year ended June 30, 2017. Management performed their analysis through September 26, 2017, which is the date the consolidated financial statements were issued. Since July 1, 2017, the Organization has entered into new partnerships that support the mission of its community-based, nonprofit organization. Through a management service agreement (MSA) the Organization will partner with Elizabeth Supportive Medical Services, an aligned physician medical group, that will allow for expansion of reimbursable services provided by the Organization. In the hospice and palliative care landscape, Scripps Health announced the closing of its hospice program and sought the expertise of the Organization to support the transition of patients and hospice staff. The Organization will play an integral role in meeting the needs of the communities impacted by Scripps Hospice closing.

**NOTE 2 - PATIENT ACCOUNTS RECEIVABLE**

Receivables from patients and third-party payors for the years ended June 30 are as follows:

| | 2017 | 2016 |
|---|---|---|
| Medicare | $ 2,746,800 | $ 2,845,292 |
| Medicaid | 739,162 | 739,686 |
| Commercial and other | 265,436 | 343,425 |
| | 3,751,398 | 3,928,403 |
| Allowance for uncollectible accounts | (229,231) | (309,903) |
| | $ 3,522,167 | $ 3,618,500 |

(Continued)

## NOTE 3 - INVESTMENTS AND FAIR VALUE MEASUREMENTS OF FINANCIAL INSTRUMENTS

U.S. GAAP defines fair value as the price that would be received for an asset or paid to transfer a liability (an exit price) in an Organization's principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

A fair value hierarchy requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. There are three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the Organization has the ability to access as of the measurement date. The fair values of money market funds, stocks, options, exchange traded funds ("ETFs"), mutual funds, hedge funds, and hard assets that are readily marketable are determined by obtaining quoted prices from nationally recognized securities exchanges.

Level 2: Significant other observable inputs other than Level 1 prices such as 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 market data. The Organization had no investments measured using Level 2 inputs at June 30, 2017 and 2016.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability. The Organization had no investments measured using Level 3 inputs at June 30, 2017 and 2016.

In many cases, a valuation technique used to measure fair value includes inputs from multiple levels of the fair value hierarchy. The lowest level of significant input determines the placement of the entire fair value measurement in the hierarchy.

Assets measured at fair value on a recurring basis are summarized below:

| | Fair Value Measurements at June 30, 2017 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| Investments: | | | | |
| Money market funds | $ 404,710 | $ - | $ - | $ 404,710 |
| Common stocks | 965,328 | - | - | 965,328 |
| Exchange traded funds | 5,708,993 | - | - | 5,708,993 |
| Equity mutual funds | 1,831,680 | - | - | 1,831,680 |
| Fixed income mutual funds | 1,480,776 | - | - | 1,480,776 |
| Hedge funds | 243,349 | - | - | 243,349 |
| Hard assets | 227,779 | - | - | 227,779 |
| Total investments | $ 10,862,615 | $ - | $ - | $ 10,862,615 |

(Continued)

**NOTE 3 - INVESTMENTS AND FAIR VALUE MEASUREMENTS OF FINANCIAL INSTRUMENTS** (Continued)

| | Fair Value Measurements at June 30, 2016 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| Investments: | | | | |
| Money market funds | $ 398,167 | $ - | $ - | $ 398,167 |
| Stocks, options, and ETFs | | | | |
| Domestic equity | 3,811,812 | - | - | 3,811,812 |
| Domestic fixed income | 739,226 | - | - | 739,226 |
| International equity | 968,535 | - | - | 968,535 |
| Alternative investment | 512,317 | - | - | 512,317 |
| Mutual funds | | | | |
| Domestic equity | 205,513 | - | - | 205,513 |
| Domestic fixed income | 701,407 | - | - | 701,407 |
| Alternative income | 364,300 | - | - | 364,300 |
| Alternative investment | 483,013 | - | - | 483,013 |
| Total investments | $ 8,184,290 | $ - | $ - | $ 8,184,290 |

The following schedule summarizes return on investments for the years ended June 30:

| | 2017 | 2016 |
|---|---|---|
| Interest and dividends, net of fees | $ 124,930 | $ 115,614 |
| Realized gains on investments | 113,389 | 1,291,029 |
| | 238,319 | 1,406,643 |
| Unrealized gains (losses) on investments | 656,427 | (1,427,634) |
| | $ 894,746 | $ (20,991) |

Investment securities are exposed to various risks, such as interest rate, market, and credit. 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 would result in material changes in the fair value of investments and net assets of the Organization.

**NOTE 4 - PROPERTY AND EQUIPMENT**

The Organization's property and equipment and the related accumulated depreciation at June 30 are as follows:

| | 2017 | 2016 |
|---|---|---|
| Land | $ 879,235 | $ 879,235 |
| Buildings | 2,989,829 | 2,953,803 |
| Office equipment | 1,371,486 | 1,296,873 |
| Furniture and fixtures | 538,971 | 451,700 |
| | 5,779,521 | 5,581,611 |
| Less accumulated depreciation | (2,461,350) | (2,126,638) |
| | $ 3,318,171 | $ 3,454,973 |

Depreciation expense for the years ended June 30, 2017 and 2016 was $334,712 and $346,587, respectively.

(Continued)

**NOTE 5 - LINES OF CREDIT**

The Organization maintains a $1,500,000 line of credit with a financial institution bearing interest at the prime rate plus 1% (4.50% as of June 30, 2017 and 2016). The line of credit is secured by cash, investments, and other assets of the Organization and expires in December 2018. The Organization had no borrowings outstanding on the line of credit at June 30, 2017 or 2016.

In March 2017, the Organization obtained a $1,000,000 line of credit with a financial institution bearing interest at LIBOR plus 1.75% (2.98% as of June 30, 2017). The line of credit is secured by cash, investments, and other assets of the Organization and expires in May 2021. The Organization had no borrowings outstanding on the line of credit at June 30, 2017.

**NOTE 6 - TEMPORARILY RESTRICTED NET ASSETS**

Temporarily restricted net assets are available for the following purposes at June 30:

| | 2017 | 2016 |
|---|---|---|
| Building fund - Canterbury | $ 30,109 | $ 30,109 |
| Unappropriated endowment earnings | 339,817 | 92,094 |
| Other | 108,588 | 99,983 |
| | $ 478,514 | $ 222,186 |

Temporarily restricted net assets were released from restriction for the years ended June 30 for the following purposes:

| | 2017 | 2016 |
|---|---|---|
| Building fund - Canterbury | $ - | $ 29,527 |
| Other | 98,612 | 13,654 |
| | $ 98,612 | $ 43,181 |

**NOTE 7 - ENDOWMENT ASSETS**

Overview: The Organization's endowments consist of various investment securities, most of which are traded on public markets. The endowments are made up of board designated, temporarily restricted, and permanently restricted assets. As required by U.S. GAAP, net assets associated with these endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

Interpretation of Relevant Law: The Organization's Board of Directors has determined the requirements of California's version of the Uniform Prudent Management of Institutional Funds Act ("UPMIFA") to center around the preservation of the fair value of the original investment as of the date of the asset transfer. The investments resulting from donations directing that they be invested in perpetuity are classified as permanently restricted. The earnings generated by these investments are classified as temporarily restricted. The temporarily restricted earnings are reclassified as unrestricted upon their appropriation for expenditure by the Organization in a manner consistent with the standard of prudence prescribed by California’s version of UPMIFA. The Organization considers the following factors in making a determination to appropriate or accumulate its endowment funds:

(Continued)

**NOTE 7 - ENDOWMENT ASSETS** (Continued)

(1) The duration and preservation of the fund
(2) The purposes of the Organization and the donor-restricted endowment fund
(3) General economic conditions
(4) The possible effect of inflation and deflation
(5) The expected total return from income and the appreciation of investments
(6) Other resources of the Organization
(7) The investment policies of the Organization

Return Objectives and Risk Parameters: The Organization has adopted investment and spending policies for endowment assets that attempt to provide funding for operating expenses of programs supported by its endowments, while maintaining the original corpus of the endowments. In order to meet this objective, the endowment asset portfolio is structured to achieve a compound annual return, net of investment management expenses, of 8% to 10%. Risk parameters are set so that reasonable volatility, including larger potential fluctuations of principal, will be tolerated over the investment horizon, in as much as it is consistent with the volatility of a comparable market index. Endowment assets include assets of donor-restricted funds that the Organization must hold in perpetuity and assets of the Organization that the Board of Directors has designated for endowment purposes.

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 broadly diversified portfolio to achieve its long-term return objectives within prudent risk constraints.

Spending Policy and How the Investment Objectives Relate to Spending Policy: The Organization disburses funds as needed within the guidelines of the endowments. Over the long-term, the Organization expects the current spending policy to allow its endowment to grow at the average annual rate of inflation over ten years. This is consistent with the Organization's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment return.

Fund with Deficiencies: From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or UPMIFA requires the Organization to retain as a fund of perpetual duration. Cumulative deficiencies of this nature that are in excess of related temporarily restricted amounts are reported in unrestricted net assets. There were no such deficiencies as of June 30, 2017 and 2016.

Endowment Net Asset Composition by Type of Fund: The Organization's composition of endowment assets as of and for the years ended June 30 is as follows:

2017:

| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
|---|---|---|---|---|
| Board designated | $ 4,663,087 | $ - | $ - | $ 4,663,087 |
| Donor-restricted | - | 339,817 | 2,580,327 | 2,920,144 |
| Total endowment | $ 4,663,087 | $ 339,817 | $ 2,580,327 | $ 7,583,231 |

(Continued)

**NOTE 7 - ENDOWMENT ASSETS** (Continued)

2016:

| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
|---|---|---|---|---|
| Donor-restricted | - | 92,094 | 2,580,327 | 2,672,421 |
| Total endowment | $ - | $ 92,094 | $ 2,580,327 | $ 2,672,421 |

Change in Endowment Net Assets: The Organization's change in endowment assets, by net asset composition, for the years ended June 30 is as follows:

2017:

| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
|---|---|---|---|---|
| Beginning balance | $ - | $ 92,094 | $ 2,580,327 | $ 2,672,421 |
| Interest and dividends, net of fees | 35,180 | 35,272 | - | 70,452 |
| Net realized and unrealized gains | 322,893 | 212,451 | - | 535,344 |
| Additions | 4,305,014 | - | - | 4,305,014 |
| Total endowment | $ 4,663,087 | $ 339,817 | $ 2,580,327 | $ 7,583,231 |

2016:

| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
|---|---|---|---|---|
| Beginning balance | $ - | $ 96,818 | $ 2,580,327 | $ 2,677,145 |
| Interest and dividends, net of fees | - | 23,652 | - | 23,652 |
| Net realized and unrealized losses | - | (28,376) | - | (28,376) |
| Total endowment | $ - | $ 92,094 | $ 2,580,327 | $ 2,672,421 |

**NOTE 8 - OPERATING LEASE COMMITMENTS**

The Organization has various operating leases for office spaces and vehicles that expire on various dates through February 2023. Total rent expense amounted to $1,581,981 and $1,278,461 for the years ended June 30, 2017 and 2016, respectively. Future minimum lease commitments are as follows:

| | |
|---|---|
| 2018 | $ 1,005,414 |
| 2019 | 917,301 |
| 2020 | 875,363 |
| 2021 | 902,240 |
| 2022 | 930,815 |
| Thereafter | 597,259 |
| | $ 5,228,392 |

(Continued)

**NOTE 9 - RETIREMENT PLAN**

The Organization maintains a qualified deferred compensation 401(k) plan for full time employees over age 21 that have completed one month of service. Under the plan, employees may elect to defer up to a percentage of pretax annual compensation, subject to the Internal Revenue Service limits. The Organization matches 50% of the participant's contribution to the Plan, not to exceed six percent of the participant's gross compensation. The Organization contributed $348,373 and $452,074 for the years ended June 30, 2017 and 2016, respectively.