# Gateway Homes, Inc.

Combined Financial Statements

September 30, 2016

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**GATEWAY HOMES, INC.**

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## REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors of
Gateway Homes, Inc.
Chesterfield, Virginia

### Report on the Combined Financial Statements

We have audited the accompanying combined financial statements of Gateway Homes, Inc. and Gateway Farms (collectively, the “Organization”), which comprise the combined statement of financial position as of September 30, 2016, and the related combined statements of activities, functional expenses, and cash flows for the year then ended, and the related notes to the combined financial statements.

### Management's Responsibility for the Combined Financial Statements

Management is responsible for the preparation and fair presentation of these combined financial statements in accordance with accounting principles generally accepted in the United States; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of combined 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 combined financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the combined financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the combined 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 combined 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 combined financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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**Opinion**

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the combined financial position of Gateway Homes, Inc. and Gateway Farms as of September 30, 2016, and the changes in their net assets and their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States.

**Report on Summarized Comparative Information**

The September 30, 2015 combined financial statements were audited by other accountants, and their report thereon, dated March 24, 2016, expressed an unmodified opinion on those combined financial statements. In our opinion, the summarized comparative information presented herein as of and for the year ended September 30, 2015, is consistent, in all material respects, with the audited combined financial statements from which it has been derived.

Keiter

March 21, 2017
Glen Allen, Virginia

**GATEWAY HOMES, INC.**

Combined Statements of Financial Position
September 30, 2016 With Summarized Totals as of September 30, 2015

| | 2016 | 2015 |
|---|---|---|
| Current assets: | | |
| Cash and cash equivalents | $ 75,839 | $ 76,547 |
| Cash - HUD | 172,844 | 161,889 |
| Investments - current | 70,000 | 70,000 |
| Accounts receivable - net | 321,026 | 142,426 |
| Prepaid expenses and other | 42,654 | 31,945 |
| Total current assets | 682,363 | 482,807 |
| Property and equipment: | | |
| Land | 306,029 | 306,029 |
| Buildings and improvements | 3,339,987 | 3,348,258 |
| Furniture and equipment | 151,740 | 285,925 |
| Vehicles | 220,025 | 294,285 |
| Construction in progress | 3,568 | 2,000 |
| | 4,021,349 | 4,236,497 |
| Less accumulated depreciation | (1,315,315) | (1,632,984) |
| Total property and equipment - net | 2,706,034 | 2,603,513 |
| Investments - noncurrent | 2,898,355 | 2,905,339 |
| Total assets | $ 6,286,752 | $ 5,991,659 |

See accompanying notes to combined financial statements.

**GATEWAY HOMES, INC.**

Combined Statements of Financial Position, Continued
September 30, 2016 With Summarized Totals as of September 30, 2015

| | 2016 | 2015 |
|---|---|---|
| Current liabilities: | | |
| Mortgage payable - current | $ 12,277 | $ 11,238 |
| Note payable - current | 82,344 | - |
| Accounts payable | 62,042 | 27,273 |
| Accrued expenses | 135,500 | 109,488 |
| Liability under charitable gift annuity - current | 70,000 | 70,000 |
| Deferred revenue | - | 75,180 |
| Total current liabilities | 362,163 | 293,179 |
| Mortgage payable - noncurrent | 275,348 | 286,402 |
| Note payable - noncurrent | 166,345 | - |
| Liability under charitable gift annuity - noncurrent | 207,039 | 151,136 |
| Total liabilities | 1,010,895 | 730,717 |
| Net assets: | | |
| Unrestricted: | | |
| Undesignated | 2,188,731 | 2,213,410 |
| Board designated | 1,029,975 | 995,238 |
| | 3,218,706 | 3,208,648 |
| Temporarily restricted | 813,494 | 808,637 |
| Permanently restricted | 1,243,657 | 1,243,657 |
| Total net assets | 5,275,857 | 5,260,942 |
| Total liabilities and net assets | $ 6,286,752 | $ 5,991,659 |

See accompanying notes to combined financial statements.

**GATEWAY HOMES, INC.**

Combined Statements of Activities
Year Ended September 30, 2016 With Summarized Totals for the Year Ended September 30, 2015

| | Unrestricted | | | | | | |
|---|---|---|---|---|---|---|---|
| | Undesignated | Board Designated | Total | Temporarily Restricted | Permanently Restricted | 2016 Total | 2015 Total |
| Revenues, gains, and other support: | | | | | | | |
| Resident fees | $ 2,774,499 | $ - | $ 2,774,499 | $ - | $ - | $ 2,774,499 | $ 2,135,478 |
| Grants | 4,400 | - | 4,400 | 314,000 | - | 318,400 | 231,150 |
| Contributions | 140,861 | - | 140,861 | 2,180 | - | 143,041 | 105,481 |
| Federal housing assistance | 124,281 | - | 124,281 | - | - | 124,281 | 121,595 |
| Gain on sale of assets | - | - | - | - | - | - | 800 |
| Investment income (loss), net | 171,322 | - | 171,322 | 192,010 | - | 363,332 | (1,028) |
| Miscellaneous | 2,806 | - | 2,806 | - | - | 2,806 | 3,054 |
| | 3,218,169 | - | 3,218,169 | 508,190 | - | 3,726,359 | 2,596,530 |
| Net assets transferred | (34,737) | 34,737 | - | - | - | - | - |
| Net assets released from restriction | 503,333 | - | 503,333 | (503,333) | - | - | - |
| Total revenues, gains, and other support | 3,686,765 | 34,737 | 3,721,502 | 4,857 | - | 3,726,359 | 2,596,530 |
| Expenses and losses: | | | | | | | |
| Program services | 3,018,947 | - | 3,018,947 | - | - | 3,018,947 | 2,294,138 |
| Management and general | 342,188 | - | 342,188 | - | - | 342,188 | 636,871 |
| Fundraising | 224,405 | - | 224,405 | - | - | 224,405 | 169,116 |
| Total expenses | 3,585,540 | - | 3,585,540 | - | - | 3,585,540 | 3,100,125 |
| Change in value of charitable gift annuity | 125,904 | - | 125,904 | - | - | 125,904 | 61,042 |
| Total expense and losses | 3,711,444 | - | 3,711,444 | - | - | 3,711,444 | 3,161,167 |
| Change in net assets | (24,679) | 34,737 | 10,058 | 4,857 | - | 14,915 | (564,637) |
| Net assets, beginning of year | 2,213,410 | 995,238 | 3,208,648 | 808,637 | 1,243,657 | 5,260,942 | 5,825,579 |
| Net assets, end of year | $ 2,188,731 | $ 1,029,975 | $ 3,218,706 | $ 813,494 | $ 1,243,657 | $ 5,275,857 | $ 5,260,942 |

See accompanying notes to combined financial statements.

## GATEWAY HOMES, INC.

Combined Schedules of Functional Expenses
Year Ended September 30, 2016 With Summarized Totals for the Year Ended September 30, 2015

| | 2016 | | | | 2015 |
|---|---|---|---|---|---|
| | Program Services | Management and General | Fundraising | Total | Total |
| Salaries and related expenses: | | | | | |
| Salaries | $ 1,772,030 | $ 162,638 | $ 85,223 | $ 2,019,891 | $ 1,757,417 |
| Contract labor | 62,625 | 5,748 | 3,012 | 71,385 | 63,913 |
| Employee benefits and payroll taxes | 314,354 | 23,626 | 18,666 | 356,646 | 266,822 |
| Total salaries and related expenses | 2,149,009 | 192,012 | 106,901 | 2,447,922 | 2,088,152 |
| Expenses: | | | | | |
| Fairfax program expense | 76,187 | 64 | - | 76,251 | 53,574 |
| Food | 40,274 | - | - | 40,274 | 43,703 |
| Human rights affiliates expense | 297 | - | - | 297 | 495 |
| Insurance | 68,776 | 7,642 | - | 76,418 | 68,003 |
| Medical supplies | 1,778 | - | - | 1,778 | 5,160 |
| Occupancy - Chesterfield | 141,495 | - | - | 141,495 | 164,033 |
| Occupancy - CSS Program | 72,031 | - | - | 72,031 | 73,246 |
| Office expenses | 35,491 | 23,012 | 14,518 | 73,021 | 55,577 |
| Other operating expenses | 60,490 | 28,063 | 609 | 89,162 | 44,788 |
| Penalties and interest | - | 3,270 | - | 3,270 | 918 |
| Professional fees | 24,098 | 78,666 | 100,772 | 203,536 | 141,205 |
| Program imitative supplies | 5,384 | - | - | 5,384 | 3,742 |
| PSR program expenses | 29,346 | - | - | 29,346 | 27,327 |
| Resident expenses | 132,976 | - | - | 132,976 | 139,384 |
| Staff development | 26,957 | 3,171 | 1,586 | 31,714 | 26,610 |
| Transportation | 31,460 | 6,288 | 19 | 37,767 | 28,576 |
| Total expenses before depreciation | 2,896,049 | 342,188 | 224,405 | 3,462,642 | 2,964,493 |
| Depreciation | 122,898 | - | - | 122,898 | 135,632 |
| Total functional expenses | $ 3,018,947 | $ 342,188 | $ 224,405 | $ 3,585,540 | $ 3,100,125 |

See accompanying notes to combined financial statements.

**GATEWAY HOMES, INC.**

Combined Statements of Cash Flows
Year Ended September 30, 2016 With Summarized Totals for Year Ended September 30, 2015

| | 2016 | 2015 |
|---|---|---|
| Cash flow from operating activities: | | |
| Change in net assets | $ 14,915 | $ (564,637) |
| Adjustments to reconcile change in net assets to net cash from operating activities: | | |
| Bad debt expense | 32,194 | 28,050 |
| Depreciation | 122,898 | 135,632 |
| Gain on disposal of property and equipment | - | (800) |
| Investment income reinvested | (363,332) | 109,280 |
| Change in value of charitable gift annuity obligation | 125,904 | (8,957) |
| Change in: | | |
| Accounts receivable - net | (210,795) | 154,158 |
| Grants receivable | - | 40,000 |
| Prepaid expenses | (10,393) | (2,042) |
| Accounts payable | 34,769 | (34,817) |
| Accrued expenses | 26,012 | 24,846 |
| Deferred revenue | (75,180) | 75,180 |
| Net cash used in operating activities: | (303,008) | (44,107) |
| Cash flow from investing activities: | | |
| Net deposits to reserves for replacements, minimum capital, and interest earned on cash - HUD | (10,955) | (19,838) |
| Proceeds from sale of property and equipment | - | 800 |
| Purchase of property and equipment | (225,419) | (145,524) |
| Proceeds from sale of investments | 300,000 | 811,722 |
| Purchase of Investments | - | (847,271) |
| Net withdrawal from investments for annuity payments | 70,000 | 70,000 |
| Net cash provided by (used in) investing activities | 133,626 | (130,111) |
| Cash flows from financing activities: | | |
| Principal payments on mortgage payable | (10,015) | (10,287) |
| Proceeds from note payable | 248,689 | - |
| Charitable gift annuity obligation distributions | (70,000) | (70,000) |
| Net cash provided by (used in) financing activities | 168,674 | (80,287) |

See accompanying notes to combined financial statements.

**GATEWAY HOMES, INC.**

Combined Statements of Cash Flows, Continued
Year Ended September 30, 2016 With Summarized Totals for Year Ended September 30, 2015

| | 2016 | 2015 |
|---|---|---|
| Net change in cash and cash equivalents | $ (708) | $ (254,505) |
| Cash and cash equivalents, beginning of year | 76,547 | 331,052 |
| Cash and cash equivalents, end of year | $ 75,839 | $ 76,547 |
| Supplemental disclosure of cash flow information: | | |
| Cash paid for interest | $ 30,311 | $ 26,841 |

See accompanying notes to combined financial statements.

**1. Nature of Activities:**

Gateway Homes, Inc., incorporated in Virginia in 1983, is a transitional residential treatment program for individuals with serious mental illness whose primary goal is to live as independently as possible. Gateway Farms was established to serve as a rural residential facility. The two corporations share common staff and are collectively referred to herein as the Organization. All intercompany transactions and balances are eliminated in these combined financial statements.

**2. Summary of Significant Accounting Policies:**

**Basis of Accounting:** The accompanying combined financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States ("GAAP") as determined by the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC").

**Basis of Presentation:** The combined financial statements include certain prior year summarized comparative information in total but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with GAAP. Accordingly, such information should be read in conjunction with the Organization's combined financial statements for the year ended September 30, 2015, from which the summarized information was derived.

The Organization is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets.

Unrestricted net assets – Net assets that are not subject to donor-imposed restrictions. Unrestricted net assets include the revenues and expenses of the primary operations of the Organization. If the Board specifies a purpose where none has been stated by the original donor, such assets are classified as board-designated within unrestricted net assets. Board-designated assets totaled $1,029,975 at September 30, 2016.

Temporarily restricted net assets – Net assets that are stipulated by donors for specific purposes or which have temporary time restrictions. When a donor restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the combined statement of activities as net assets released from restrictions.

Permanently restricted net assets – Net assets that are subject to donor-imposed stipulations that require the Organization maintain them permanently.

## 2. Summary of Significant Accounting Policies, Continued:

**Use of Estimates:** The preparation of combined 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 and disclosure of contingent assets and liabilities at the date of the combined financial statements and the reported amounts of revenues and expenses during the periods reported. Actual results could differ from those estimates.

**Cash and Cash Equivalents:** The Organization considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents.

**Accounts Receivable:** Accounts receivable include amounts due from the U.S. Government and Virginia community service boards for services provided to residents and are reported net of an allowance for doubtful accounts. The allowance is based on management's estimate of the amount of receivables that will actually be collected. As of September 30, 2016, the allowance for doubtful accounts was $34,530.

**Investments:** Investments in marketable securities with readily determinable fair values and all investments in debt securities are valued at their fair values in the combined statement of financial position. Net income or loss, including unrealized gains and losses, is included in the change in net assets in the accompanying combined statement of activities.

**Property and Equipment:** Property and equipment are stated at cost or, if donated, appraised value at date of gift. Major repairs and betterments are capitalized and normal maintenance and repairs are charged to expense as incurred. Depreciation is computed by the straight-line method over the estimated useful lives of the related assets, which range from 5 to 40 years.

**Valuation of Long-Lived Assets:** The Organization accounts for the valuation of long-lived assets under GAAP, which requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. Recoverability of the long-lived assets is measured by a comparison of the carrying amount of the assets to future undiscounted net cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets. Assets to be disposed of are reportable at the lower of carrying amount or fair value, less cost to sell. There were no impairments identified during 2016.

## 2. Summary of Significant Accounting Policies, Continued:

**Resident Fees:** Resident fees are reported at estimated net realizable amounts from resident and third-party payors for services rendered. Revenue from the Medicaid program accounted for a significant portion of the Organization’s resident fees for 2016 . Laws and regulations governing the Medicaid program are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Medicaid income accounted for 18% of resident fees in 2016. In addition, approximately 28% of the Organization's resident fees for 2016 are funded by a single Virginia county.

**Contributions:** Contributions received are recorded as unrestricted, temporarily restricted, or permanently restricted support depending on the nature of donor restrictions, if any.

Donor-restricted support is reported as an increase in temporarily or permanently restricted net assets depending on the nature of the restriction. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets. Endowment contributions are permanently restricted by the donor.

Contributions of assets other than cash are recorded at their estimated fair market value at the time of donation. There were no non-cash contributions during 2016.

**Contributed Materials and Services:** In accordance with GAAP, the Organization records the value of contributed materials and the value of contributed services that either (a) created or enhanced a nonfinancial asset or (b) required specialized skills, was provided by individuals possessing those skills, and would typically need to be purchased if they had not been contributed. There were no such contributed materials or services during 2016. In addition, many individuals volunteer their time and perform a variety of tasks that assist the Organization with specific programs, campaign solicitations and various committee assignments. The value of these services are not recognized in the combined financial statements.

**Functional Expenses:** The costs of providing the various programs and other activities have been summarized on a functional basis in the combined statement of activities and in the combined statement of functional expenses. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

**Income Taxes:** The Organization is exempt from income taxes under the provision of Section 501(c)(3) of the Internal Revenue Code.

## 2. Summary of Significant Accounting Policies, Continued:

**Income Tax Uncertainties:** The Organization follows the FASB guidance for how uncertain tax positions should be recognized, measured, disclosed and presented in the combined financial statements. This requires the evaluation of tax positions taken or expected to be taken in the course of preparing the Organization's tax returns to determine whether the tax positions are "more-likely-than-not" of being sustained "when challenged" or "when examined" by the applicable tax authority. Tax positions not deemed to meet the more-likely-than-not threshold would be recorded as a tax expense and liability in the current year. Management has evaluated the Organization's tax position and concluded that the Organization had taken no uncertain tax positions that require adjustment to the combined financial statements to comply with the provisions of this guidance. The Organization is not currently under audit by any tax jurisdiction.

**Concentration of Credit Risk:** Financial instruments that potentially subject the Organization to concentrations of credit risk consist principally of cash and cash equivalents, accounts receivable, and investments.

The Organization maintains its cash in bank deposit accounts which, at times, may exceed federally insured limits. The Organization has not experienced any losses in such accounts and believes it is not exposed to any significant financial credit risk on cash.

The Organization has receivables due from federal and state governments and agencies. Management believes credit risk related to these receivables is limited due to their nature.

The Organization invests in various investments securities, which 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 risk in the near term would affect the investment balance and the amount reported in the accompanying combined financial statements.

**Reclassification:** Certain prior year balances have been reclassified to conform with the current year presentation.

**Subsequent Events:** Management has evaluated subsequent events through March 21, 2017, the date the combined financial statements were available to be issued, and has determined there are no subsequent events to be reported in the accompanying combined financial statements.

**3. Reserves and Residual Receipts:**

The Organization has an agreement with the U.S. Department of Housing and Urban Development ("HUD") whereby HUD is to provide additional funding based on the financial needs of the Organization's residents.

The regulatory agreement with HUD requires that the Organization establish and maintain a reserve fund for replacements. HUD also requires the Organization to establish a reserve for residual receipts. These restricted balances are segregated from operating cash in a separate bank account and can only be withdrawn with HUD approval.

**4. Investments:**

At September 30, 2016, investments consist of the following:

| | Cost | Market Value | Unrealized Gain |
|---|---|---|---|
| Money market funds | $ 175,247 | $ 175,247 | $ - |
| Common stock | 1,835,936 | 2,400,977 | 565,041 |
| Mutual funds | 9,439 | 11,877 | 2,438 |
| Corporate bonds | 372,326 | 380,254 | 7,928 |
| | $ 2,392,948 | $ 2,968,355 | $ 575,407 |

Investment income, net consist of the following:

| | |
|---|---|
| Interest and dividend income | $ 92,303 |
| Realized and unrealized gains, net | 282,827 |
| Investment expenses | (11,798) |
| | $ 363,332 |

## 5. Fair Value Measurements:

The Organization follows FASB guidance with respect to fair value measurements. This guidance provides a framework for measuring fair value under GAAP, for all financial assets and liabilities measured at fair value on a recurring basis.

The guidance establishes a three-level hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). If the inputs used to measure the assets or liabilities fall within different levels of the hierarchy, the classification is based on the lowest level that is significant to the fair value measurement of the asset or liability.

Classification of assets and liabilities within the hierarchy considers the market in which the assets or liabilities are traded and the reliability and transparency of the assumptions used to determine fair value. The hierarchy requires the use of observable market data when available. The levels of the hierarchy are defined as follows:

> Level 1 - Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Organization has the ability to access.
>
> Level 2 – Inputs to the valuation methodology are quoted prices for similar instruments in active and inactive markets; and model driven valuations with significant inputs and drivers derived from observable active markets.
>
> Level 3 - Inputs to the valuation methodology are unobservable and significant to the fair value measurement. There were no assets or liabilities classified as Level 3 at September 30, 2016.

The following is a description of the valuation methodologies used for assets measured at fair value:

***Money market:*** Valued at the cash balance.

***Common stock:*** Valued at the closing price as reported on the active market on which stocks are traded.

***Mutual funds:*** Valued at the net asset value ("NAV") of shares held in the fund at the end of the trading day.

***Corporate bonds:*** Valued at the closing price as reported on the active market on which bonds are traded.

***Charitable Gift Annuity Obligation:*** Valued at present value of the future payment obligations under the annuity agreement.

**GATEWAY HOMES, INC.**

Notes to Combined Financial Statements, Continued

## 5. Fair Value Measurements, Continued:

Assets and liabilities measured at fair value at September 30, 2016 include the following:

| | Level 1 | Level 2 | Total |
|---|---|---|---|
| Money market funds | $ 175,247 | $ - | $ 175,247 |
| Common stocks: | | | |
| Closed-end mutual funds | 39,994 | - | 39,994 |
| Consumer discretionary | 289,496 | - | 289,496 |
| Consumer staples | 391,740 | - | 391,740 |
| Energy | 158,126 | - | 158,126 |
| Financials | 433,307 | - | 433,307 |
| Health care | 179,626 | - | 179,626 |
| Industrials | 349,315 | - | 349,315 |
| Information technology | 86,076 | - | 86,076 |
| Materials | 113,643 | - | 113,643 |
| Real estate investment trusts | 235,771 | - | 235,771 |
| Telephone | 79,693 | - | 79,693 |
| Utilities | 44,190 | - | 44,190 |
| Mutual funds | 11,877 | - | 11,877 |
| Corporate bonds | 380,254 | - | 380,254 |
| | $ 2,968,355 | $ - | $ 2,968,355 |
| Charitable gift annuity obligation | $ - | $ 277,039 | $ 277,039 |

## 6. Fairfax Property:

The Organization received donated property valued at $298,184 from the County of Fairfax during 2013. A promissory note agreement for the same amount was simultaneously entered into by the Organization and the County of Fairfax. The promissory note agreement, dated April 25, 2013, bears no interest and is not required to be repaid as long as the housing remains available to extremely low and moderate income persons for a period of 30 years. The promissory note is secured by a deed of trust on the property. Upon non-compliance with the agreement, the promissory note shall become immediately due and payable at an annual interest rate of the prime rate plus four basis points. The donated value of the property is reflected in the Organization's temporarily restricted net assets in the combined statement of financial position. Since the possibility of failing to meet the use criteria is remote, the note payable has not been recorded by the Organization.

## 7. Charitable Gift Annuity Obligation:

The Organization is a remainder beneficiary of a charitable gift annuity dated 2001 which is recorded at the present value of the expected payout based on the life expectancy of the donor. The discount rate is the IRS Section 7520 rate. The annual payout is $70,000. During the term of the agreement, any changes in actuarial assumptions are recognized as "change in charitable gift annuity obligation" in the accompanying combined statements of activities.

A summary of the change in the invested balance and obligation liability of the charitable gift annuity for the year ended September 30, 2016, is as follows:

| | Invested Balance | Annuity Obligation | Net |
|---|---|---|---|
| Balance - beginning of year | $ 1,117,768 | $ 221,135 | $ 896,633 |
| Annuity payments | (70,000) | (70,000) | - |
| Other withdrawals | (300,000) | - | (300,000) |
| Investment income, net | 125,583 | - | 125,583 |
| Change in value | - | 125,904 | (125,904) |
| Balance - end of year | $ 873,351 | $ 277,039 | $ 596,312 |

During 2016, the Organization withdrew $300,000 from the invested balance to account for previous years' annuity payments.

## 8. Note Payable:

In May 2016, the Organization entered into a promissory note in the amount of $250,000 with a commercial bank. The note requires interest only payments until June 2017 and principal and interest payments through maturity on May 18, 2018. Interest is calculated at the Wall Street Journal Prime Rate plus .25% (3.75% at September 30, 2016). The note is secured by certain assets of the Organization. The outstanding balance on the note was $248,689 at September 30, 2016. Future minimum principal payments are $82,344 for 2017 and $166,345 for 2018.

## 9. Mortgage Payable - HUD:

The mortgage payable to HUD is collateralized by Gateway Farms' land and improvements and will mature September 1, 2029. The monthly payment of $3,100 includes interest at 8.875%. The principal balance at September 30, 2016, was $287,625.

## 9. Mortgage Payable – HUD, Continued:

Future minimum principal payments as of September 30, 2016, are as follows:

| Year Ended September 30: | Amount |
|---|---|
| 2017 | $ 12,277 |
| 2018 | 13,412 |
| 2019 | 14,652 |
| 2020 | 16,007 |
| 2021 | 17,487 |
| Thereafter | 213,790 |
| | $ 287,625 |

Under agreements with HUD, the Organization is required to make monthly deposits for replacement of project assets and is subject to restrictions as to operating policies, rental charges, operating expenditures, and distributions. The liability of the Organization under the mortgage note is limited to the underlying value of the real estate.

## 10. Restricted Net Assets:

Temporarily restricted net assets at September 30, 2016, consist of the following:

| | |
|---|---|
| Affordable low income housing | $ 260,122 |
| Nurse practitioner salaries and related expenses | 55,948 |
| Occupational therapist | 15,941 |
| Accumulated endowment earnings | 481,483 |
| | $ 813,494 |

## 10. Restricted Net Assets, Continued:

Net assets were released from donor restrictions during 2016 by incurring expenses satisfying the restricted purposes, as follows:

| | |
|---|---|
| Affordable low income housing | $ 19,601 |
| Lights and paving | 12,224 |
| Nurse practitioner salaries and related expenses | 309,769 |
| Occupational therapist | 51,559 |
| Vehicles | 108,000 |
| Other | 2,180 |
| | $ 503,333 |

Permanently restricted net assets consist of endowment fund investments to be held indefinitely. The income from these assets is used to support the Organization's programs or as stipulated by the donor.

## 11. Endowment Funds:

The Organization has several endowment funds established to support its programs. The endowment funds include both donor-restricted endowment funds and funds designated by the Board of Directors to function as endowments. Net assets associated with endowment funds, including funds designated by the Board of Directors to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions as required by GAAP.

**Interpretation of Relevant Law:** The Board of Directors of the Organization has interpreted the Uniform Prudent Management of Institutional Funds Act ("UPMIFA") as requiring the preservation of the fair value of the original gift of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Organization classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor restricted endowment funds that are not classified as permanently restricted net assets are classified as temporarily restricted net assets until those amounts appropriated for expenditure are disbursed in accordance with the donor restrictions in a manner consistent with the standard of prudence prescribed by UPMIFA.

## 11. Endowment Funds, Continued:

In accordance with UPMIFA, the Organization considers the following factors in making a determination to appropriate or accumulate funds in the endowment funds designated by the Board of Directors:

- The duration and preservation of the fund
- The purposes of the organization and the donor-restricted endowment fund
- General economic conditions
- The possible effect of inflation and deflation
- The expected total return from income and the appreciation of investments
- Other resources of the organization
- The investment policies of the organization

**Return Objectives and Risk Parameters:** The objective of the Organization's investment policy is to achieve long-term growth in principal while preserving capital through investment in a diversified portfolio of quality investment securities, producing a favorable investment return as compared against inflation. Notwithstanding this investment policy, all restrictions placed by donors or by law on the interest and investment earnings on any funds and their use shall be honored.

**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's asset allocation ranges for various asset classes shall be established from time to time by the Board of Directors with the assistance of the investment manager.

**Spending Policy and How the Investment Objectives Relate to Spending Policy:** The Organization has a spending policy for the Board of Directors to periodically review and determine when it is necessary or desirable in connection with the execution of Organization's strategic plans and policies to make distributions from endowment funds other than as specifically required by donors. The income that may be spent, as determined by the Board of Directors or the donor's direction, may be drawn from both ordinary income earned (i.e., dividends, interest, etc.) and appreciation, both realized and unrealized.

**Funds with Deficits:** From time to time, the fair value of assets associated with individual endowment funds may fall below the level that the donor or the UPMIFA requires the Organization to retain as a fund of perpetual duration. In accordance with GAAP, deficiencies of this nature are reported in unrestricted net assets. There were no endowment funds with deficiencies of this nature as of September 30, 2016.

## 11. Endowment Funds, Continued:

Endowment net asset composition by type of fund was as follows as of September 30, 2016:

| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
|---|---|---|---|---|
| Donor-restricted endowment | $ - | $ 481,483 | $ 1,243,657 | $ 1,725,140 |
| Board-designated endowment | 1,029,975 | - | - | 1,029,975 |
| | $ 1,029,975 | $ 481,483 | $ 1,243,657 | $ 2,755,115 |

Changes in endowment net assets were as follows for the year ended September 30, 2016:

| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
|---|---|---|---|---|
| Endowment net assets - beginning of year | $ 995,238 | $ 268,306 | $ 1,243,657 | $ 2,507,201 |
| Investment income | - | 48,016 | - | 48,016 |
| Net realized and unrealized gain | - | 150,554 | - | 150,554 |
| Investment fees | - | (6,429) | - | (6,429) |
| Transfers | 104,737 | 21,167 | - | 125,904 |
| Appropriated for expenditures | (70,000) | (131) | - | (70,131) |
| Endowment net assets - end of year | $ 1,029,975 | $ 481,483 | $ 1,243,657 | $ 2,755,115 |

## 12. Retirement Plan:

The Organization sponsors a SIMPLE IRA covering qualified employees. Employer contributions to the plan are made at the discretion of the Board of Directors. The Organization matched the employee contributions up to a maximum of 3% of gross wages for 2016 in the amount of $46,110.

## 13. Related Party Transactions:

A member of the Board of Directors is the account officer for the Organization's investment account held by a third party. A portion of the investment fees, which totaled $11,798 for 2016, is paid to the board member by the investment company.

## 14. Contingent Liabilities:

In April 2015, the Organization was notified of an alleged overpayment of $292,704 received from the Department of Medical Assistance Services ("DMAS"). The overpayment is related to the location code used on claims to Virginia Medicaid. The Organization appealed the alleged overpayment and the amount in dispute was reduced to $283,545 during the informal appeals process. The Organization then appealed through the administrative appeals process at the informal and formal levels. Management is unable to predict the outcome of the proceedings; however, the Hearing Officer at the formal level recommended that the proposed retractions be reversed in their entirety and the Organization be awarded their attorney fees. At the present time, the Organization is awaiting a decision by DMAS concerning whether the recommended decision of the Hearing Officer will be accepted in whole or in part. Management is unable to predict the outcome of the appeal but believes that the amount in dispute will be retracted and that the legal fees will be recovered. No provision has been made in the accompanying combined financial statements to reflect the decision of DMAS.

## 15. New Accounting Guidance:

In August 2016, FASB issued ASU No. 2016-14, "Not-For-Profit Entities (Topic 958): Presentation of Financial Statements of Not-For-Profit Entities", which both simplifies certain aspects of reporting required by not-for-profit organizations and increases disclosures with a goal to improve the usefulness of not-for-profit financial statements to the various stakeholders, including management, directors, lenders, and donors. Significant changes include the following:

- Replaces the existing three classes of net assets (unrestricted, temporarily restricted, and permanently restricted) with two new classes of net assets—net assets with donor restrictions and net assets without donor restrictions

- Changes the net asset classification of the underwater amounts of donor-restricted endowment funds to be shown as a component of *net assets with donor restrictions* and requires additional disclosures for underwater endowment funds

- Requires all not-for-profits to provide expenses by nature and function

- Requires expansive disclosures (both quantitative and qualitative) of information about liquidity and availability of resources

The amendments in this ASU are effective for fiscal years beginning after December 15, 2017 with early adoption permitted. The Organization has elected not to early adopt this ASU and intends to adopt it prior to the required transition date.