

CIRCLE THE CITY AND SUBSIDIARIES

**Consolidated Financial Statements
and
Supplementary Information**

**Year Ended June 30, 2017
(with comparative totals for 2016)**

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Independent Auditors' Report

To the Board of Directors of
Circle the City and Subsidiaries
Phoenix, Arizona

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Circle the City and Subsidiaries (the Organization, a nonprofit corporation and affiliates), which comprise the consolidated statement of financial position as of June 30, 2017, and the related consolidated statements of activities, functional expenses and cash flows for the year then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated 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 consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Circle the City and Subsidiaries as of June 30, 2017, 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 of America.

Report on Summarized Comparative Information

We have previously audited the Organization's 2016 consolidated financial statements, and we expressed an unmodified opinion on those audited consolidated financial statements in our report dated January 23, 2017. In our opinion, the summarized comparative information presented herein as of and for the year ended June 30, 2016, is consistent in all material respects, with the consolidated audited financial statements from which it has been derived.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated November 27, 2017, on our consideration of the Organization's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Organization's internal control over financial reporting and compliance.

Fester & Chapman, PLLC

November 27, 2017

Circle the City and Subsidiaries

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

June 30, 2017
(with comparative totals as of June 30, 2016)

	ASSETS	
	<u>2017</u>	<u>2016</u>
Current assets:		
Cash and cash equivalents	\$ 2,789,278	\$ 2,210,693
Accounts receivable, net	669,877	395,685
Government grants receivable	319,469	321,768
Contributions receivable, current portion	303,000	311,500
Prepaid expenses	<u>58,171</u>	<u>47,846</u>
Total current assets	4,139,795	3,287,492
Contributions receivable, non-current portion	250,000	300,000
Property and equipment, net	<u>2,654,926</u>	<u>2,938,311</u>
Total assets	<u>\$ 7,044,721</u>	<u>\$ 6,525,803</u>
	LIABILITIES AND NET ASSETS	
Current liabilities:		
Accounts payable	\$ 357,606	\$ 268,828
Accrued expenses	98,093	97,869
Accrued payroll and related	372,431	318,184
Line of credit	50,000	50,000
Unearned revenue	<u>739,006</u>	<u>774,821</u>
Total current liabilities	1,617,136	1,509,702
Net assets:		
Unrestricted:		
Unrestricted	4,749,245	4,141,285
Board designated for long-lived assets		<u>200,000</u>
Total unrestricted	4,749,245	4,341,285
Temporarily restricted	<u>678,340</u>	<u>674,816</u>
Total net assets	<u>5,427,585</u>	<u>5,016,101</u>
Total liabilities and net assets	<u>\$ 7,044,721</u>	<u>\$ 6,525,803</u>

The accompanying notes are an integral part of these statements.

Circle the City and Subsidiaries

CONSOLIDATED STATEMENT OF ACTIVITIES

Year Ended June 30, 2017
(with comparative totals for the year ended June 30, 2016)

	Unrestricted	Temporarily Restricted	Totals	
			2017	2016
Revenue and support:				
Healthcare services revenue	\$ 5,210,689		\$ 5,210,689	\$ 3,105,640
Contributions and grants	703,684	\$ 604,832	1,308,516	1,934,945
Government grants	1,147,042		1,147,042	1,192,932
Contributions in-kind	73,007		73,007	53,943
Total support and revenue, before special events and net assets released from restrictions	<u>7,134,422</u>	<u>604,832</u>	<u>7,739,254</u>	<u>6,287,460</u>
Special events:				
Special events revenue	424,808		424,808	386,587
Less cost of direct donor benefits	<u>(56,735)</u>		<u>(56,735)</u>	<u>(50,982)</u>
Special events, net	<u>368,073</u>		<u>368,073</u>	<u>335,605</u>
Net assets released from restrictions - operating	570,976	(570,976)		
Net assets released from restrictions - capital	<u>30,332</u>	<u>(30,332)</u>		
Total net assets released from restrictions	<u>601,308</u>	<u>(601,308)</u>		
Total revenue and support	8,103,803	3,524	8,107,327	6,623,065
Expenses:				
Healthcare services	6,204,658		6,204,658	5,235,757
Management and general	940,648		940,648	588,038
Fundraising	<u>550,537</u>		<u>550,537</u>	<u>381,444</u>
Total expenses	<u>7,695,843</u>		<u>7,695,843</u>	<u>6,205,239</u>
Change in net assets, before discontinued operations	407,960	3,524	411,484	417,826
Net loss from discontinued operations				<u>(491,812)</u>
Change in net assets	407,960	3,524	411,484	(73,986)
Net assets, beginning of year	<u>4,341,285</u>	<u>674,816</u>	<u>5,016,101</u>	<u>5,090,087</u>
Net assets, end of year	<u>\$ 4,749,245</u>	<u>\$ 678,340</u>	<u>\$ 5,427,585</u>	<u>\$ 5,016,101</u>

The accompanying notes are an integral part of these statements.

Circle the City and Subsidiaries

CONSOLIDATED STATEMENT OF FUNCTIONAL EXPENSES

Year Ended June 30, 2017
 (with comparative totals for the year ended June 30, 2016)

	Healthcare Services	Supporting Services		Totals	
		Management and General	Fundraising	2017	2016
Salaries and personnel costs	\$ 3,576,858	\$ 820,700	\$ 477,994	\$ 4,875,552	\$ 3,649,208
Direct program expenses	678,304	9,076	221	687,601	490,984
Grants to other agencies					75,380
Travel	31,504	2,170	1,325	34,999	19,553
Insurance	80,699	3,491	1,510	85,700	103,769
Bank and credit card fees	387	53	6,865	7,305	4,906
Marketing			9,159	9,159	15,878
Professional services	613,041	12,852	39,352	665,245	614,970
Facility and equipment	821,885	89,335	2,982	914,202	828,907
Depreciation	388,163	2,104	88	390,355	390,604
Interest	821	123	74	1,018	1,390
Other	12,996	744	10,967	24,707	9,690
Total expenses	<u>\$ 6,204,658</u>	<u>\$ 940,648</u>	<u>\$ 550,537</u>	<u>\$ 7,695,843</u>	<u>\$ 6,205,239</u>

The accompanying notes are an integral part of these statements.

Circle the City and Subsidiaries

CONSOLIDATED STATEMENT OF CASH FLOWS

Year Ended June 30, 2017
(with comparative totals for the year ended June 30, 2016)

	<u>2017</u>	<u>2016</u>
Cash flows from operating activities:		
Change in net assets	\$ 411,484	\$ 417,826
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Net loss from discontinued operations		(491,812)
Depreciation	390,355	390,604
Depreciation related to discontinued operations		17,275
Donated equipment	(41,915)	
Gain on asset disposal		(6,037)
Loss on asset disposal related to discontinued operations		17,806
Change in:		
Accounts receivable, net	(274,192)	88,800
Government grants receivable	2,299	(221,482)
Contributions receivable	58,500	226,761
Prepaid expenses	(10,325)	21,204
Accounts payable	88,778	161,645
Accrued expenses	224	(7,583)
Accrued payroll and related	54,247	97,414
Unearned revenue	<u>(35,815)</u>	<u>559,129</u>
Net cash provided by operating activities	<u>643,640</u>	<u>1,271,550</u>
Cash flows from investing activities:		
Acquisition of property and equipment	(65,055)	(830,170)
Withdrawals from restricted bank account		<u>188,542</u>
Net cash used by investing activities	<u>(65,055)</u>	<u>(641,628)</u>
Cash flows from financing activities:		
Contributions restricted for long-term purposes		<u>500,000</u>
Net cash provided by financing activities		<u>500,000</u>
Net change in cash and cash equivalents	578,585	1,129,922
Cash and cash equivalents, beginning of year	<u>2,210,693</u>	<u>1,080,771</u>
Cash and cash equivalents, end of year	<u>\$ 2,789,278</u>	<u>\$ 2,210,693</u>
<u>Supplemental disclosure of cash flow information:</u>		
Cash paid for interest	\$ 1,018	\$ 1,552

The accompanying notes are an integral part of these statements.

Circle the City and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2017

(with comparative totals as of and for the year ended June 30, 2016)

NOTE 1 - BACKGROUND AND SUMMARY OF ACCOUNTING POLICIES

Circle the City (the Organization) was incorporated in Arizona in March 2008 as a nonprofit corporation. The Organization's mission is to create and deliver innovative healthcare solutions that compassionately address the needs of men, women, and children facing homelessness. The Organization's inaugural program is Arizona's first medical respite center and provides care to people experiencing homelessness in Maricopa County. The Organization provides homeless men and women "a time and place to heal" after they are discharged from local hospitals or referred by other sources for respite services. The Organization partners with most major hospital systems in the Phoenix area, as well as, contracts with the relevant health insurance payers to bridge the gap between inpatient and outpatient care, ensuring that patients have the best opportunity to heal physically, socially, and emotionally. More recently, the Organization opened the Parsons Family Health Center at Circle the City and received the designation of federally qualified health center.

In August 2009, the Organization formed a subsidiary Circle the City Holdings, LLC (Holdings), with the Organization as the sole member. Holdings was formed to hold selected long-lived assets, as well as to receive and ultimately sell donated property. See Note 12.

In September 2012, the Organization opened a Medical Respite Center ("MRC") which is used to provide short-term housing and supportive services for homeless persons attempting to recover from illness or injury. The MRC comprises 50 beds capable of serving 400 to 500 homeless persons annually. Services are offered to homeless patients who are ready for hospital discharge, but need additional time and support to fully recover, and/or homeless persons who are sick, but do not meet hospital admission criteria. Services are provided under block funding and unit of service contracts with certain hospitals and other health-care agencies.

In March 2015, the Organization formed a subsidiary Circle the City Behavioral Health, LLC (Behavioral Health), with the Organization as the sole member. Behavioral Health was formed to provide behavioral health services to mentally ill people experiencing homelessness, specifically as an independent contractor for the Regional Behavioral Health Authority (RBHA). Effective June 2016, the Organization discontinued the operations of Behavioral Health. See Note 2.

In May 2015, the Organization received notice of award from the Health Resources and Services Administration (HRSA) of a new access point grant establishing the Organization as a federally qualified health center. On September 1, 2015, the Organization opened the Parsons Family Health Center, a primary care practice with a comprehensive offering of integrative services available on site including behavioral healthcare, psychiatry, substance abuse therapy and case management. Additionally, a 2-exam room mobile clinic provides outreach services to the community as an extension of the fixed site practice. This practice will care for more than 3,800 homeless men, women and children each year. In addition to the significant federal grant, this new program was made possible through the support of The Bob & Renee Parsons Foundation and the Virginia G. Piper Charitable Trust.

Circle the City and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2017

(with comparative totals as of and for the year ended June 30, 2016)

NOTE 1 - BACKGROUND AND SUMMARY OF ACCOUNTING POLICIES (CONTINUED)

The significant accounting policies of the Organization follow:

Basis of Presentation: The accompanying consolidated financial statements have been prepared in accordance with the recommendations of Financial Accounting Standards Board Accounting Standards Codification (FASB ASC) topic of *Not-for-Profit Entities*. 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. Temporarily restricted net assets are those whose use by the Organization has been limited by donors to a specific time period or purpose. There were no permanently restricted net assets at June 30, 2017 and 2016.

Prior Year Summarized Information: The accompanying consolidated 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 accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with the Organization's consolidated financial statements for the year ended June 30, 2016, from which the summarized information was derived.

Principles of Consolidation: The accompanying consolidated financial statements of Circle the City and Subsidiaries include the accounts of the Organization and its wholly-owned subsidiaries: Circle the City Holdings, LLC and Circle the City Behavioral Health, LLC. See Note 2.

Use of Estimates: The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the 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.

Cash and Cash Equivalents: Cash equivalents consist of highly liquid financial instruments purchased with original maturities of three months or less. Cash and cash equivalents are insured in limited amounts by the Federal Deposit Insurance Corporation (FDIC). The Organization has not experienced material losses in such accounts and believes it is not exposed to significant credit risks.

Restricted Cash: Restricted cash consists of amounts which were donor-restricted for construction of the Parsons Family Health Center.

Circle the City and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2017

(with comparative totals as of and for the year ended June 30, 2016)

NOTE 1 - BACKGROUND AND SUMMARY OF ACCOUNTING POLICIES (CONTINUED)

Accounts Receivable: Accounts receivable are stated at the amount management expects to collect under the terms of the contract agreements with third parties. Management provides for probable uncollectible amounts through a charge to earnings and a credit to a valuation allowance based on its assessment of the current status of individual receivables. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to receivables.

Contributions Receivable: Contributions receivable are stated at net present value of expected cash flows, less an allowance for doubtful accounts, as deemed necessary, and are recognized as contribution revenue in the year the unconditional promise to give is made. The Organization provides for losses on receivables using the allowance method. The allowance is based on experience, knowledge of the donor, the industry and other circumstances which may affect the ability of donors to meet their obligations. It is the Organization's policy to charge off uncollectible pledges receivable when management determines the receivable will not be collected.

Property and Equipment: Purchased property and equipment is recorded at cost and donated property and equipment is recorded at the estimated fair value at the date of gift to the Organization. Maintenance and repairs are expensed when incurred. Betterments and renewals in excess of \$2,500 are capitalized. Depreciation and amortization of property and equipment is computed using the straight-line method over the following estimated useful lives:

Leasehold improvements	Lesser of the estimated useful life or remaining term of applicable lease
Buildings and improvements	10 - 30 years
Medical equipment	5 - 10 years
Furniture and fixtures	3 - 10 years
Vehicles	2 - 4 years
Computer equipment and software	3 years

Contributions: The Organization accounts for contributions in accordance with FASB ASC's topic of *Not-for-Profit Entities*. Contributions received are recorded as unrestricted, temporarily restricted, or permanently restricted support, depending on the existence and/or nature of any donor restrictions. All donor-restricted support is reported as an increase in temporarily or permanently restricted net assets depending on the nature of the restrictions. When a restriction expires (that is, when a stipulated time restriction ends or purpose restriction is accomplished), restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statement of activities as net assets released from restrictions. Approximately 32% of contributions were received from one nonprofit organization and one private donor in fiscal year 2017, and 41% of contributions were received from three nonprofit organizations during the year ended June 30, 2016.

Circle the City and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2017

(with comparative totals as of and for the year ended June 30, 2016)

NOTE 1 - BACKGROUND AND SUMMARY OF ACCOUNTING POLICIES (CONTINUED)

Grants: The Organization recognizes grants that are considered exchange transactions as support when eligible costs are incurred or revenues are earned.

Healthcare Service Revenue: The Organization has unit of service contracts with health plans, hospitals and other healthcare facilities, and records contract amounts as earned when respite services are rendered. A receivable is recorded when respite services have been rendered, but reimbursement has not been received by the Organization. Conversely, a liability (unearned revenue) is recorded when contract payments exceed amounts earned.

Charity Care: The Organization does not recognize revenue for services provided without charge to patients who meet the criteria of its charity care policy. The Organization desires to assure that no patient will be denied health care services due to an individual's inability to pay for such services and wishes to ensure that any fees or payments required for such services will be reduced or waived for eligible patients. In accordance with HRSA requirements, the Organization offers all services within the approved scope of project, whether required or additional, under a sliding fee discount schedule and, accordingly, no patient will be denied services based on their inability to pay. Therefore, many eligible patients receive charity care in the absence of an external payer covering costs of services rendered to them. The Organization treats all patients referred to the Organization who meet basic admitting criteria without consideration of financial status, demographic, or any protected class. All patients referred to the Organization are eligible for charity care in the absence of an external payer covering costs of services rendered to them.

During the years ended June 30, 2017 and 2016, the Organization conducted 3,802 and 2,919 patient care encounters, respectively, under its charity care policy for the Medical Respite and Parsons Family Clinic programs at an estimated cost of \$1,013,280 and \$996,500, respectively.

Donated Services: Donated services are recognized as contributions if the services create or enhance nonfinancial assets, or require specific skills and are performed by people with those skills, and would otherwise be purchased. No amounts have been recorded in the consolidated financial statements for certain donated volunteer services because they did not qualify for recognition.

Functional Expenses: The costs of providing programs and other activities have been summarized on a functional basis in the accompanying consolidated statement of activities and the consolidated statement of functional expenses. Accordingly, certain costs have been allocated among the programs and supporting services benefited. Directly identifiable expenses are charged to programs and supporting services. Expenses related to more than one function are charged to program and supporting services on the basis of personnel activity and other allocation methods.

Circle the City and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2017

(with comparative totals as of and for the year ended June 30, 2016)

NOTE 1 - BACKGROUND AND SUMMARY OF ACCOUNTING POLICIES (CONTINUED)

Income Taxes: The Organization is exempt from federal and state income taxes as an organization other than a private foundation under Section 501(c)(3) of the Internal Revenue Code and similar provisions.

NOTE 2 - DISCONTINUED OPERATIONS

Effective June 2016, the Organization ceased operations of Circle the City Behavioral Health, LLC. The following table provides information about the net loss from discontinued operations presented in the consolidated statement of activities for the year ended June 30, 2016.

Revenue	\$ 556,721
Salaries and personnel costs	(642,274)
General and administrative expenses	(371,178)
Depreciation	(17,275)
Loss on sale of assets	<u>(17,806)</u>
Net loss from discontinued operations	<u><u>\$ (491,812)</u></u>

As of June 30, 2017 and 2016, the Organization had unearned revenue related to discontinued operations totaling approximately \$675,000 that was received in advance of services provided under its behavioral health services contracts.

NOTE 3 - ACCOUNTS RECEIVABLE, NET

Accounts receivable consist of charges to patients for healthcare services provided to them. Settled charges have been adjusted by a sliding fee schedule based on each patient's ability to pay. Allowances for contractual adjustments and doubtful accounts have been provided to cover receivable amounts management estimates will not be collected.

The amount due from Arizona Health Care Cost Containment System (AHCCCS) is included in accounts receivable, net, and it represents the Organization's unreimbursed cost of providing primary health care to its AHCCCS members. Beginning in fiscal year 2017, the Center was required to complete an annual reconciliation between the costs of providing healthcare services to its AHCCCS members, and the payments received from the third party AHCCCS insurance plans.

The following is a summary at June 30:

	<u>2017</u>	<u>2016</u>
Accounts receivable, healthcare and respite services	\$ 487,477	\$ 438,825
Due from AHCCCS	219,000	
Allowance for contractual adjustments and doubtful accounts	<u>(36,600)</u>	<u>(43,140)</u>
Accounts receivable, net	<u><u>\$ 669,877</u></u>	<u><u>\$ 395,685</u></u>

Circle the City and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2017

(with comparative totals as of and for the year ended June 30, 2016)

NOTE 4 - CONTRIBUTIONS RECEIVABLE

Contributions receivable consisted of the following at June 30:

	<u>2017</u>	<u>2016</u>
Due in less than one year	\$ 303,000	\$ 311,500
Due in one to five years	200,000	225,000
Due in more than five years	<u>50,000</u>	<u>75,000</u>
Total due in more than one year	<u>250,000</u>	<u>300,000</u>
Total contributions receivable	<u><u>\$ 553,000</u></u>	<u><u>\$ 611,500</u></u>

Approximately 77% of contributions receivable were due from two nonprofit organizations and one private donor at June 30, 2017, and 70% of contributions receivable were due from three nonprofit organizations at June 30, 2016. Management considers contributions receivable to be fully collectible at June 30, 2017 and 2016, and accordingly, an allowance for doubtful accounts has not been provided.

NOTE 5 - PROPERTY AND EQUIPMENT, NET

Property and equipment consisted of the following at June 30:

	<u>2017</u>	<u>2016</u>
Leasehold improvements	\$ 1,508,156	\$ 1,508,156
Building and improvements	1,527,645	1,462,016
Medical equipment	200,228	200,228
Furniture and fixtures	230,659	230,659
Vehicles	293,921	305,126
Computer equipment and software	<u>177,605</u>	<u>136,265</u>
Total cost or donated value	3,938,214	3,842,450
Less accumulated depreciation	<u>(1,283,288)</u>	<u>(904,139)</u>
Property and equipment, net	<u><u>\$ 2,654,926</u></u>	<u><u>\$ 2,938,311</u></u>

NOTE 6 - TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets activity was as follows during the year ended June 30, 2017:

	<u>Beginning balance</u>	<u>Additions</u>	<u>Releases</u>	<u>Ending balance</u>
Purpose restrictions:				
Operating expenses	\$ 207,316	\$ 273,500	\$ (363,476)	\$ 117,340
Salaries and wages	32,500	45,000	(47,500)	30,000
Capital projects		86,332	(30,332)	56,000
Time restrictions:				
Contributions receivable, without purpose restrictions	<u>435,000</u>	<u>200,000</u>	<u>(160,000)</u>	<u>475,000</u>
	<u><u>\$ 674,816</u></u>	<u><u>\$ 604,832</u></u>	<u><u>\$ (601,308)</u></u>	<u><u>\$ 678,340</u></u>

Circle the City and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2017

(with comparative totals as of and for the year ended June 30, 2016)

NOTE 6 - TEMPORARILY RESTRICTED NET ASSETS (CONTINUED)

Temporarily restricted net assets activity was as follows during the year ended June 30, 2016:

	<u>Beginning balance</u>	<u>Additions</u>	<u>Releases</u>	<u>Ending balance</u>
Purpose restrictions:				
Operating expenses	\$ 931,943	\$ 717,447	\$(1,442,074)	\$ 207,316
Salaries and wages	23,625	32,500	(23,625)	32,500
Capital projects	688,541	50,000	(738,541)	
Time restrictions:				
Contributions receivable, without purpose restrictions	<u>229,500</u>	<u>435,000</u>	<u>(229,500)</u>	<u>435,000</u>
	<u>\$ 1,873,609</u>	<u>\$ 1,234,947</u>	<u>\$(2,433,740)</u>	<u>\$ 674,816</u>

NOTE 7 - CONTRIBUTIONS IN-KIND

The Organization recognized the following donated assets and services during the years ended June 30:

	<u>2017</u>	<u>2016</u>
Donated equipment	\$ 41,915	
Respite services	<u>31,092</u>	<u>\$ 53,943</u>
	<u>\$ 73,007</u>	<u>\$ 53,943</u>

NOTE 8 - OPERATING LEASE

On February 29, 2012, the Organization entered into a ten year building lease agreement with another Arizona nonprofit corporation. The lease provides for two optional renewal periods of five years each. The terms of the lease require the Organization to pay an annual minimum rent payment of \$12 per year. The lease also provides for contingent rental payments in the form of up to 1,000 bed days annually to be provided to the lessor. The number of bed days to be provided to the lessor is based upon a good faith effort of the Organization to provide such bed days and the needs of the lessor for such services. The 1,000 bed days to be provided to the lessor do not prorate or roll over from year to year.

The Organization recognizes the expenses and revenue for this contingent rent at the cost of the actual services provided to the lessor in the period the services are rendered. For the years ended June 30, 2017 and 2016, the Organization provided 1,095 bed days to the lessor at an estimated cost of \$219,000, which has been recorded in the accompanying consolidated financial statements as direct program expenses and healthcare services revenue.

Circle the City and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2017

(with comparative totals as of and for the year ended June 30, 2016)

NOTE 9 - LINE OF CREDIT

In conjunction with the operating lease noted above, the Organization entered into an unsecured bridge loan with a revolving line of credit for \$2,500,000 with the same Arizona nonprofit corporation. The agreement was executed on May 1, 2012 with an interest rate of 2% annually. The agreement provides for monthly payments of interest only and is cancelable with sixty days notice by either party. At June 30, 2017 and 2016 the Organization owed \$50,000 on the line of credit.

NOTE 10 - RETIREMENT PLAN

During the year ended June 30, 2017, the Organization adopted a qualified, defined contribution plan under IRC 403(b) (the Plan). All full-time employees who work 1000 hours over 12 consecutive months are eligible to participate in the Plan after their probationary employment period. The Organization matches employee contributions up to 4% of compensation (a 100% match of employee contributions for the first 2% of compensation, followed by an additional 50% match on the second 2% of compensation). Therefore, the total possible employer contribution equates to 3% of compensation for those employees who contribute 4% of their compensation. The Organization's contributions to the Plan totaled \$69,710 during the year ended June 30, 2017.

The employee contributions are 100% vested at the time of contribution. The employer contributions are vested based on prorata vesting schedule based on the number of years' of service the employee has with the Organization. The employee is 100% vested once 4 years of service has been attained.

The Organization utilizes a third party administrator to handle all required plan administration and filings. The Organization is not currently required to have a Plan audit under ERISA guidelines.

NOTE 11 - COMMITMENTS AND CONTINGENCIES

Service Agreements: The Organization has multi-year, noncancellable service and lease agreements with vendors expiring through June 2022. Total future minimum commitments under these agreements at June 30, 2017 are as follows:

<u>Years Ending June 30,</u>	
2018	\$ 237,010
2019	225,092
2020	220,094
2021	219,000
2022	145,800
Total	<u>\$ 1,046,996</u>

Circle the City and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2017

(with comparative totals as of and for the year ended June 30, 2016)

NOTE 11 - COMMITMENTS AND CONTINGENCIES (CONTINUED)

Compliance: The Organization participates in federally-funded and state-funded programs administered by various government agencies. The programs included in these financial statements may be subject to program compliance and/or financial monitoring by the granting agencies or their representatives. The amount, if any, of expenses which may be disallowed by the granting agencies cannot be determined at this time.

Healthcare Regulations: The healthcare industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government healthcare program participation requirements, reimbursement for patient services, and Medicare fraud and abuse. Government activity has increased with respect to investigations and allegations concerning possible violations of laws and regulations by health care providers. Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties as well as significant repayments for patient services previously billed. Management believes that the Organization is in compliance with applicable government laws and regulations. While no regulatory inquiries have been made, compliance with laws and regulations can be subject to future review and interpretation as well as regulatory actions unknown or unasserted at this time.

The Health Insurance Portability and Accountability Act of 1996 (HIPAA) broadened the scope of certain fraud and abuse laws by adding several criminal provisions for fraud offenses that apply to all health benefit programs. HIPAA also added a prohibition against incentives intended to influence decisions by Medicare beneficiaries as to the provider from which they receive services. HIPAA was followed by the Balanced Budget Act of 1997, which created additional fraud and abuse provisions, including civil penalties for contractors.

HIPAA developed standards to protect the privacy and security of individually identifiable health-related information. The privacy standards regulate the use and disclosure of health-related information, whether communicated electronically, on paper or orally. Also, additional security regulations became mandatory on April 20, 2005, and require health care providers to implement administrative, physical and technical practices to protect the security of individually identifiable health-related information that is maintained or transmitted electronically. In February 2010, HIPAA requirements were updated by the Health Information Technology for Economic and Clinical Health Act (HITECH Act). Under the HITECH Act, violations of HIPAA requirements could now result in civil penalties of up to \$50,000 per incident, and up to \$1.5 million in total for each type of violation in a calendar year.

Professional Liability Insurance: The Federally Supported Health Centers Assistance Act of 1992 authorizes the Public Health Service to assume responsibility for medical malpractice claims involving approved grantees and certain other health care providers under the Federal Tort Claims Act (FTCA). The Organization is currently covered under the FTCA. In addition, the Organization carries general liability insurance coverage; however, it is possible that future claims related to services provided could be settled for amounts in excess of insurance coverage limits.

Circle the City and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2017

(with comparative totals as of and for the year ended June 30, 2016)

NOTE 12 - RELATED PARTY TRANSACTIONS

As discussed in Note 1, Circle the City Holdings, LLC (Holdings) is a subsidiary of the Organization that was formed to hold selected long-lived assets. During the year ended June 30, 2015, Holdings purchased a building in Phoenix, which it converted into an outpatient community health center. The \$799,000 building purchase was financed with proceeds from a \$2 million contribution that the Organization received from The Bob & Renee Parsons Foundation. The Organization received designation as a federally qualified health center and the associated federal funding, in May 2015. The community health center opened in September 2015.

NOTE 13 - SUBSEQUENT EVENTS

Subsequent events have been evaluated through November 27, 2017, which was the date the Organization's financial statements were issued.