# MORNINGSIDE MINISTRIES AND SUBSIDIARIES

# CONSOLIDATED FINANCIAL STATEMENTS
# AND SUPPLEMENTAL INFORMATION

## YEARS ENDED DECEMBER 31, 2016 AND 2015

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CliftonLarsonAllen LLP
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# INDEPENDENT AUDITORS' REPORT

Board of Directors
Morningside Ministries and Subsidiaries
San Antonio, Texas

## Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Morningside Ministries and Subsidiaries, (a Texas corporation), which comprise the consolidated balance sheet as of December 31, 2016, and the related consolidated statements of operations, changes in net assets, and cash flows for the year then ended, and the related notes to the consolidated financial statements.

### *Management's Responsibility for the Consolidated 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. 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 auditor's 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 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 2016 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Morningside Ministries and Subsidiaries as of December 31, 2016, and the results of its operations, 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 2015 consolidated financial statements of Morningside Ministries and Subsidiaries were audited by other auditors whose report dated April 27, 2016, expressed an unmodified opinion on those consolidated financial statements. As discussed in Note 2 to the consolidated financial statements, Morningside Ministries and Affiliates has adjusted its 2015 consolidated financial statements to retrospectively apply the change in accounting for debt issuance costs and to reclassify certain amounts to conform to the 2016 presentation for comparative purposes with no effect on previously reported net assets. The other auditors reported on the consolidated financial statements before the retrospective adjustment and reclassifications.

As part of our audit of the 2016 consolidated financial statements, we also audited the adjustments to the 2015 consolidated financial statements to retrospectively apply the change in accounting and reclassifications as described in Note 2. In our opinion, such adjustments and reclassifications are appropriate and have been properly applied. We were not engaged to audit, review, or apply any procedures to Morningside Ministries and Subsidiaries' 2015 consolidated financial statements other than with respect to the adjustments and reclassifications and, accordingly, we do not express an opinion or any other form of assurance on the 2015 consolidated financial statements as a whole.

***Emphasis of Matter***

As discussed in Note 2 to the consolidated financial statements, Morningside Ministries and Affiliates adopted a recently issued accounting standard related to the accounting for debt issuance costs. The new standard requires entities to present debt issuance costs as a direct reduction from the face amount of the related borrowings, amortize debt issuance costs using the effective interest method over the life of the debt, and record the amortization as a component of interest expense. Our opinion is not modified with respect to this matter.

**Report on Supplemental Information**

*Other Information*

Our audit was conducted for the purpose of forming an opinion on the 2016 consolidated financial statements as a whole. The 2016 consolidated schedule of unrestricted functional expenses and the 2016 consolidating balance sheet, statement of operations and changes in unrestricted net assets and changes in net assets on pages 35 – 40 are presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations, and cash flows of the individual companies, and it is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements.

Board of Directors
Morningside Ministries and Subsidiaries

**Report on Supplemental Information (Continued)**

*Other Information (continued)*

The consolidating information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the consolidating information is fairly stated in all material respects in relation to the consolidated financial statements as a whole. The 2015 consolidated schedule of unrestricted functional expenses was subjected to the auditing procedures applied in the 2015 audit of the basic consolidated financial statements by other auditors, whose report on such information stated that it was fairly stated in all material respects in relation to the 2015 consolidated financial statements as a whole.

CliftonLarsonAllen LLP

**CliftonLarsonAllen LLP**

Dallas, Texas
April 17, 2017

**MORNINGSIDE MINISTRIES AND SUBSIDIARIES**
**CONSOLIDATED BALANCE SHEETS**
**DECEMBER 31, 2016 AND 2015**

| | 2016 | 2015 |
|---|---|---|
| **ASSETS** | | |
| **CURRENT ASSETS** | | |
| Cash and Cash Equivalents | $ 9,401,194 | $ 6,407,522 |
| Resident Accounts Receivable, Net | 3,107,760 | 4,086,587 |
| Accounts Receivable, Other | 43,371 | 31,094 |
| Current Portion of Assets Limited as to Use | 2,033,988 | 2,026,563 |
| Supplies | 428,511 | 400,877 |
| Prepaid Expenses | 451,505 | 438,902 |
| Total Current Assets | 15,466,329 | 13,391,545 |
| **ASSETS LIMITED AS TO USE** | | |
| Cash and Cash Equivalents - Trustee Held | 2,034,269 | 2,026,850 |
| Reserve Fund | 3,548,238 | 3,548,238 |
| Escrow Deposits - Overlook Entrance Fees | - | 1,419,355 |
| Board Designated Funds | 20,578,870 | 18,990,603 |
| Endowment and Temporarily Restricted Investments | 17,691,638 | 17,340,902 |
| Total Assets Limited as to Use | 43,853,015 | 43,325,948 |
| Less: Current Portion of Assets Limited as to Use | (2,033,988) | (2,026,563) |
| Total Assets Limited as to Use, Net of Current Portion | 41,819,027 | 41,299,385 |
| **PROPERTY, PLANT, AND EQUIPMENT** | 154,611,683 | 147,461,527 |
| Less: Accumulated Depreciation | (59,742,134) | (54,700,697) |
| Property, Plant, and Equipment, Net | 94,869,549 | 92,760,830 |
| **OTHER ASSETS** | | |
| Deposits | 70,000 | 50,000 |
| Other Assets | 304,428 | 20,800 |
| Total Other Assets | 374,428 | 70,800 |
| Total Assets | $ 152,529,333 | $ 147,522,560 |

*See accompanying Notes to Consolidated Financial Statements.*

| | 2016 | 2015 |
|---|---|---|
| **LIABILITIES AND NET ASSETS** | | |
| **CURRENT LIABILITIES** | | |
| Current Maturities of Long-Term Debt | $ 1,110,888 | $ 505,000 |
| Accounts Payable | 1,089,771 | 2,021,562 |
| Accrued Wages and Related Costs | 1,365,275 | 1,132,513 |
| Accrued Insurance Cost | 111,000 | 185,000 |
| Accrued Interest Payable | 1,513,988 | 1,521,563 |
| Accrued Expenses | 87,197 | 269,235 |
| Total Current Liabilities | 5,278,119 | 5,634,873 |
| **LONG-TERM LIABILITIES** | | |
| Resident Deposits | 114,872 | 1,552,343 |
| Refundable Entrance Fee Payable | 24,092,874 | 10,920,749 |
| Deferred Revenue | 3,747,153 | 1,193,443 |
| Long-Term Debt, Net | 74,509,808 | 80,121,881 |
| Total Long-Term Liabilities | 102,464,707 | 93,788,416 |
| Total Liabilities | 107,742,826 | 99,423,289 |
| **NET ASSETS** | | |
| Unrestricted | 27,094,867 | 30,758,369 |
| Temporarily Restricted | 5,810,000 | 5,514,370 |
| Permanently Restricted | 11,881,640 | 11,826,532 |
| Total Net Assets | 44,786,507 | 48,099,271 |
| Total Liabilities and Net Assets | $ 152,529,333 | $ 147,522,560 |

## MORNINGSIDE MINISTRIES AND SUBSIDIARIES
## CONSOLIDATED STATEMENTS OF OPERATIONS
## YEARS ENDED DECEMBER 31, 2016 AND 2015

| | 2016 | 2015 |
|---|---|---|
| **OPERATING REVENUE** | | |
| Net Resident Service Revenue | $ 45,095,968 | $ 44,340,069 |
| Amortization of Advance Entrance Fee Revenue | 425,049 | 238,724 |
| Other Operating Revenue | 1,050,616 | 921,990 |
| Net Assets Released from Restrictions - Operations | 801,575 | 829,939 |
| Total Operating Revenue | 47,373,208 | 46,330,722 |
| **OPERATING EXPENSES** | | |
| Program Services: | | |
| Nursing Services | 15,410,349 | 14,204,565 |
| Food Services | 6,267,294 | 5,569,451 |
| Environmental Services | 7,065,428 | 6,463,591 |
| Ancillary Services | 7,076,698 | 7,489,560 |
| Life Enrichment | 1,580,966 | 1,500,143 |
| Training Institutes and Other | 396,924 | 478,311 |
| Total Program Services | 37,797,660 | 35,705,621 |
| Administrative Expenses | 8,392,265 | 7,710,332 |
| Depreciation | 5,146,843 | 3,891,546 |
| Interest | 3,710,160 | 3,222,836 |
| Total Operating Expenses | 55,046,928 | 50,530,335 |
| **NET LOSS FROM OPERATIONS** | (7,673,720) | (4,199,613) |
| **OTHER INCOME (EXPENSE)** | | |
| Unrestricted Investment Earnings | 1,929,231 | (129,662) |
| Unrestricted Contributions | 191,093 | 151,859 |
| Loss on Sale of Property and Equipment | (2,332) | (431,475) |
| Gain on Sale of Medicaid Bed Licenses | 1,515,000 | - |
| Total Other Income | 3,632,992 | (409,278) |
| **DEFICIT OF REVENUES OVER EXPENSES** | (4,040,728) | (4,608,891) |
| Net Assets Released from Restrictions - Capital | 377,226 | 945,508 |
| **DECREASE IN UNRESTRICTED NET ASSETS** | $ (3,663,502) | $ (3,663,383) |

*See accompanying Notes to Consolidated Financial Statements.*

**MORNINGSIDE MINISTRIES AND SUBSIDIARIES**
**CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS**
**YEARS ENDED DECEMBER 31, 2016 AND 2015**

| | 2016 | 2015 |
|---|---|---|
| **UNRESTRICTED NET ASSETS** | | |
| Deficit of Revenues Over Expenses | $ (4,040,728) | $ (4,608,891) |
| Net Assets Released from Restrictions - Capital | 377,226 | 945,508 |
| Decrease in Unrestricted Net Assets | (3,663,502) | (3,663,383) |
| **TEMPORARILY RESTRICTED NET ASSETS** | | |
| Contributions | 341,210 | 1,581,702 |
| Gain (Loss) on Endowment Investments | 1,133,221 | (160,975) |
| Net Assets Released from Restrictions - Operations | (801,575) | (829,939) |
| Net Assets Released from Restrictions - Capital | (377,226) | (945,508) |
| Increase (Decrease) in Temporarily Restricted Net Assets | 295,630 | (354,720) |
| **PERMANENTLY RESTRICTED NET ASSETS** | | |
| Contributions | 55,108 | 309,672 |
| Increase in Permanently Restricted Net Assets | 55,108 | 309,672 |
| **DECREASE IN NET ASSETS** | (3,312,764) | (3,708,431) |
| Net Assets - Beginning of Year | 48,099,271 | 51,807,702 |
| **NET ASSETS - END OF YEAR** | $ 44,786,507 | $ 48,099,271 |

*See accompanying Notes to Consolidated Financial Statements.*

# MORNINGSIDE MINISTRIES AND SUBSIDIARIES
# CONSOLIDATED STATEMENTS OF CASH FLOWS
# YEARS ENDED DECEMBER 31, 2016 AND 2015

| | 2016 | 2015 |
|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | |
| Decrease in Net Assets | $ (3,312,764) | $ (3,708,431) |
| Adjustments to Reconcile Decrease in Net Assets to | | |
| Net Cash Used by Operating Activities: | | |
| Depreciation | 5,146,843 | 3,891,546 |
| Amortization of Debt Issuance Costs | 179,711 | 179,711 |
| Amortization of Advance Entrance Fees | (425,049) | (238,724) |
| Unrealized (Gains) Losses on Assets Limited as to Use | (159,054) | 1,801,544 |
| Realized Gains on Sale of Securities on Assets Limited as to Use | (2,166,168) | (730,367) |
| Loss on Sale of Property and Equipment | 2,332 | 431,475 |
| Bad Debt Provision | 536,534 | 84,953 |
| Investment Income (Net of Fees) | (737,230) | (780,540) |
| Receipt of Restricted Contributions | (396,318) | (1,891,374) |
| (Increase) Decrease in Assets: | | |
| Resident Accounts Receivable, Net | 442,293 | 422,062 |
| Accounts Receivable - Other | (12,277) | 14,490 |
| Supplies | (27,634) | (41,592) |
| Prepaid Expenses and Deposits | (32,603) | 63,018 |
| Escrow Deposits and Reserve Fund | 1,419,355 | 11,979 |
| Increase (Decrease) in Liabilities: | | |
| Accounts Payable | 193,012 | (505,306) |
| Accrued Wages and Related Costs | 232,762 | (13,709) |
| Accrued Insurance Cost | (74,000) | (90,000) |
| Accrued Expenses | (188,317) | 82,243 |
| Resident Deposits | (17,063) | 611 |
| Entrance Fee Turnover, Net | 901,080 | 282,074 |
| Net Cash Provided (Used) by Operating Activities | 1,505,445 | (734,337) |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | |
| Purchase of Property, Plant, and Equipment | (1,358,592) | (4,403,836) |
| Proceeds from Sale of Property, Plant, and Equipment | 256 | - |
| Sale of Assets Limited as to Use | 25,096,876 | 8,392,940 |
| Purchase of Assets Limited as to Use | (24,710,657) | (9,122,571) |
| Interest and Dividends on Assets Limited as to Use | 737,230 | 780,537 |
| Purchase of Home Health License | (283,628) | - |
| Net Cash Used by Investing Activities | (518,515) | (4,352,930) |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | |
| Principal Payments on Long-Term Debt | (12,505,000) | (495,000) |
| Proceeds from Long-Term Debt | 291,922 | 18,524 |
| Receipt of Restricted Contributions | 396,318 | 1,891,374 |
| Payment of Financing Costs | (5,000) | (5,000) |
| Receipt of Initial Entrance Fees | 13,835,921 | - |
| Net Cash Provided by Financing Activities | 2,014,161 | 1,409,898 |
| **NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS** | 3,001,091 | (3,677,369) |
| Cash and Cash Equivalents - Beginning of Year | 8,434,372 | 12,111,741 |
| **CASH AND CASH EQUIVALENTS - END OF YEAR** | $ 11,435,463 | $ 8,434,372 |

*See accompanying Notes to Consolidated Financial Statements.*

# MORNINGSIDE MINISTRIES AND SUBSIDIARIES
# CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)
# YEARS ENDED DECEMBER 31, 2016 AND 2015

| | 2016 | 2015 |
|---|---|---|
| **RECONCILIATION OF CASH AND CASH EQUIVALENTS TO CONSOLIDATED BALANCE SHEET** | | |
| Cash and Cash Equivalents | $ 9,401,194 | $ 6,407,522 |
| Cash and Cash Equivalents - Trustee Held | 2,034,269 | 2,026,850 |
| Cash and Cash Equivalents - End of Year | $ 11,435,463 | $ 8,434,372 |
| **SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION** | | |
| Cash Paid for Interest | $ 3,545,599 | $ 3,038,175 |
| Capitalized Interest | 72,129 | 312,704 |
| Total Cash Paid for Interest Expense | $ 3,617,728 | $ 3,350,879 |
| **NONCASH INVESTING AND FINANCING ACTIVITIES** | | |
| Purchase of Property, Plant, and Equipment acquired with Long-Term Debt | $ 7,032,182 | $ 21,403,655 |

*See accompanying Notes to Consolidated Financial Statements.*

## NOTE 1 ORGANIZATION AND NATURE OF ACTIVITIES

### Organization

Morningside Ministries (the Organization), is a not-for-profit organization that has provided long-term health care services for over 50 years in San Antonio, Texas and the surrounding area. The Organization is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code. The Organization's facilities provide retirement living, assisted-living, intermediate nursing care, skilled nursing care and rehabilitation.

Established in 1961 by the Rio Texas Conference of the United Methodist Church and five years later joined by Episcopal Diocese of West Texas and First Presbyterian Church of San Antonio, the Organization was founded with the specific mission of caring for older adults. The Organization currently has three distinct retirement communities in San Antonio and Boerne, Texas, including Morningside Ministries at the Meadows, Morningside Ministries at The Chandler Estate, and Morningside Ministries at Menger Springs as follows.

Morningside Ministries at The Meadows offers 142 independent living units, 68 assisted living units and 170 skilled nursing facility and rehabilitation units at the following:

- The Meadows Cottages
- The Meadows Atrium Apartments
- Kaulbach Assisted Living
- Morningside Manor Health Care

Morningside Ministries at The Chandler Estate offers 38 independent living units, 24 assisted living units and 113 skilled nursing facility and rehabilitation units:

- Chandler Retirement Apartments
- Chandler Center
- Chandler Assisted Living
- Chandler Health Care

Morningside Ministries at Menger Springs offers 200 independent living units (expanded by 68 units in 2016), 48 assisted living units (expanded by 32 units in 2016), 42 memory care units (expanded by 16 units in 2016) and 40 skilled nursing facility, wellness and rehabilitation units:

- Menger House Retirement Apartments
- Cibolo House Assisted Living and Memory Care
- Kendall House Wellness and Rehabilitation
- The Cottages Under the Oaks
- The Overlook

Training Institutes include:

- Elizabeth McGowen Training Institute at Morningside Ministries ("mmLearn.org")

Morningside Ministries Pharmacy

## NOTE 1 ORGANIZATION AND NATURE OF ACTIVITIES (CONTINUED)

The Morningside Ministries Foundation, Inc. (the Foundation) was formed in 1999 to operate for the benefit of the Organization and to support its programs and services. The Foundation began operations on March 31, 2001, when land, land improvements, buildings, temporarily restricted investments, and endowment investments of the Organization were transferred or conveyed to the Foundation. The Board of Directors of the Foundation shall consist of a limited number of representatives from the Organization, one of which will be the President of the Organization, and the remaining directors will be selected from a board cross-section of the community.

mmCare, LLC (mmCare) is a Texas Limited Liability Company formed in December 2016 to provide home health services to the community. The Organization is the 100% member as of December 31, 2016.

## NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Principles of Consolidation

The accompanying consolidated financial statements have been prepared in accordance with generally accepted accounting principles. The consolidated financial statements include the net assets and operations of the Organization, the Foundation, and mmCare, collectively known as the Corporation. Any inter-organization balances and transactions have been eliminated upon consolidation.

### Basis of Accounting

The consolidated financial statements of the Corporation have been prepared on the accrual basis of accounting in accordance with accounting standards generally accepted in the United States of America.

### 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 and disclosures of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and other support and expenses during the reporting period. Actual results could differ from those estimates.

## NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### Basis of Presentation

Contributions received are recorded as an increase in unrestricted, temporarily restricted or permanently restricted support, depending on the existence or nature of any donor restrictions. Accordingly, net assets of the Corporation and changes therein are classified and reported as follows:

Unrestricted – Include those net assets whose use is not restricted by donor-imposed stipulations, even though their use may be limited in other respects, such as by contract or board designation.

Temporarily Restricted – Include contributions restricted by the donor for specific purposes or time periods. When a purpose restriction is accomplished or a time restriction ends, temporarily restricted net assets are released to unrestricted net assets.

Permanently Restricted – Include contributions restricted by the donor to be invested in perpetuity. The investment return may be used to support the charity care of the Corporation.

Unconditional promises to give cash and other assets are accrued at estimated fair market value at the date each promise is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction is satisfied, net assets are released and reported as an increase in unrestricted net assets. Absent donor stipulations, investment earnings on permanently restricted net assets are classified as temporarily restricted until they are spent and released to unrestricted net assets.

### Performance Indicator

The consolidated statements of operations include deficit of revenues over expenses, known as the performance indicator. Changes in unrestricted net assets which are excluded from the performance indicator, consistent with industry practice, include unrealized gains and losses on investments and assets limited as to use other than trading securities, net asset transfers between related parties, including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets.

### Cash and Cash Equivalents

For purposes of the consolidated statement of cash flows, the Corporation considers all treasury bills and certificates of deposit with an original maturity of three months or less to be cash and cash equivalents including trustee held. Cash and cash equivalents exclude escrow deposits and short-term investments held in assets whose use is limited by Board designation, endowments or other arrangements under trust agreements.

## NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### Concentration of Credit Risk

The Corporation holds financial instruments, including cash and a variety of investment funds. Financial instruments are exposed to various risks such as interest rate, credit, and overall market volatility. Due to the level of risk associated with certain investments, it is reasonably possible that changes in the values of the instruments will occur in the near term and that such changes could materially affect account balances and the combined statements of operations. The Corporation believes it places its cash and cash equivalents, restricted cash, and temporary cash investments with high quality credit institutions. At times such investments may be in excess of the Federal Deposit Insurance Corporation insured limit.

The Corporation grants credit without collateral to its residents or their families, most of whom are local residents and who are insured under third-party payor agreements. The amounts due under the Medicare and Medicaid programs as a percentage of total resident accounts receivable at December 31, 2016 and 2015 were as follows:

| | 2016 | 2015 |
|---|---|---|
| Medicare | 15% | 15% |
| Medicaid | 23% | 18% |

### Resident Accounts Receivable

Resident accounts receivable are stated at the amount management expects to collect from outstanding balances. Management provides for probable uncollectible amounts through adjustments to the allowance for uncollectible accounts based upon an assessment of the current status of individual receivables. The allowance for uncollectible accounts was $400,000 and $402,000 at December 31, 2016 and 2015, respectively.

### Supplies

Inventories of supplies are stated at the lower of cost or market.

### Assets Limited as to Use

Assets limited as to use include funds held by bond trustees under indenture agreements, designated deposits for entrance fees, designated assets set aside by the board of directors, and assets held for endowments. The board of directors retains control of these designated assets and may, at its discretion, subsequently use these assets for other purposes. The assets limited as to use are primarily invested in money market funds, bonds, common stock and mutual funds which are carried at fair value on the consolidated balance sheets. Amounts required to meet current liabilities of the Corporation are included in current assets.

## NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### Investment Income, Gains, and Losses

Investments are stated at current market value. Investment income, gains, and losses, including net realized and unrealized appreciation (depreciation) in market value of investments restricted by donors, are reported as increases in unrestricted net assets if the restrictions are met in the reporting period in which the income and gains are recognized.

### Property, Plant, and Equipment

Property, plant and equipment are recorded at cost for purchased assets or fair market value at date of receipt for donated assets. Acquisitions or property, plant and equipment in excess of $1,500 and all expenditures for maintenance, repairs, renewals, and betterments that materially extend the useful life of the asset are capitalized. Depreciation is computed using the straight-line method over the estimated useful lives of the assets as follows:

| | |
|---|---|
| Land improvements | 20 Years |
| Buildings | 20-40 Years |
| Equipment and Furniture | 5-20 Years |
| Vehicles | 5-7 Years |

Construction in progress costs are deferred until the projects are completed and placed into service at which time these costs are depreciated over the useful life of the asset. If any of the projects are cancelled, the costs incurred will be expensed in the year determined.

### Impairment of Long-Lived Assets

On an ongoing basis, the Corporation reviews its long-lived assets, such as property, plant and equipment, and purchased intangible assets subject to amortization, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If circumstances require a long-lived asset be tested for possible impairment, the Corporation would first compare undiscounted cash flows expected to be generated by an asset to the carrying value of the asset. If the carrying value of the long-lived asset is not recoverable on an undiscounted cash flow basis, impairment is recognized to the extent that the carrying value exceeds its fair value. Fair value is determined through various valuation techniques including discounted cash flow models, quoted market values and third-party independent appraisals, as considered necessary. Management did not identify any impairment charges required to be recorded in the accompanying consolidated financial statements related to long-lived assets as of December 31, 2016 and 2015.

### Asset Retirement Obligations

Asset retirement obligations represent obligations to dispose of assets that are legally required to be removed at a future date. Such an obligation would involve the removal of asbestos, if any, in the Corporation's operating facilities. Based upon the Corporation's past experience, the costs and the potential liability for such removals are not deemed material and are addressed on a case by case basis as operating facilities are renovated. Accordingly, an asset retirement obligation has not been recognized as of December 31, 2016 and 2015.

## NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### Change in Accounting Principle – Debt Issuance Costs

The Corporation has adopted the accounting guidance in FASB Accounting Standards Update (ASU) 2015-03, *Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs*. ASU 2015-03 requires organizations to present debt issuance costs as a direct reduction from the face amount of the related borrowings, amortize the debt issuance costs using the effective interest method over the life of the debt, and record the amortization as a component of interest expense. The effect of adopting the new standard decreased the debt issuance costs asset to zero and decreased the long-term debt liability by $2,923,726 as of January 1, 2015. The adoption of this standard had no effect on previously reported net assets. The ASU is retrospectively applied.

Costs incurred in connection with the issuance of long-term debt are reported as a reduction to long-term debt and amortized over the term of the debt using the straight-line method, which approximates the effective interest method. At December 31, 2016 and 2015, debt issuance costs were $3,088,050 and $3,093,050, respectively. At December 31, 2016 and 2015, accumulated amortization of debt issuance costs was $513,746 and $344,035, respectively. Interest expense related to the debt issuance costs for the years ended December 31, 2016 and 2015 was $179,711.

### Accrued Insurance Costs

The Corporation has purchased insurance through September 1, 2016 to cover all workers' compensation claims above the policy deductible amount. After September 1, 2016, the Corporation entered into a non-subscriber policy.

The Corporation has purchased insurance to cover professional and general liability insurance claims. The policy limit is $1,000,000 for each claim, with a $3,000,000 aggregate liability limit. Prior to June 1, 2015, the deductible was $50,000 per claim. After this date, including as of December 31, 2016, there is no deductible.

### Deferred Entrance Fees

Contract arrangements for The Cottages Under the Oaks and The Overlook at Menger Springs require certain payments upon occupancy. Entrance fees paid by a resident upon entering into a residence and care agreement, net of the portion thereof that is refundable to the resident, are recorded as deferred revenue and amortized to income using the straight-line method over the estimated remaining life expectancy of the resident, or the contract term, if shorter. The period of amortization for nonrefundable entrance fees is based on the actuarially determined, estimated remaining life expectancy of the resident. Unamortized deferred revenue from entrance fees is recorded as revenue upon a resident's death or contract termination.

The refundable portion of the entrance fee is recorded as a liability as it is generally contingent upon the reoccupancy of the dwelling by a subsequent resident but the refund is not limited to the proceeds of reoccupancy. The amounts received for entrance fees are generally recorded and included in cash and cash equivalents.

## NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### Deferred Entrance Fees (Continued)

The Overlook at Menger Springs entrance fees deposits totaling $-0- and $1,419,355 at December 31, 2016 and 2015, respectively, are held in escrow and are recorded in assets limited as to use as their use is restricted.

### Net Resident Service Revenue

Net resident service revenue includes rent, room charges and ancillary services to residents of the licensed nursing facilities, assisted living facilities, senior housing apartments and related services and is recorded at established billing rates, net of contractual adjustments, resulting from agreements with third-party payors and is recognized when the services are provided.

A detail of the components of net resident service revenue is as follows for the years ended December 31:

| | 2016 | 2015 |
|---|---|---|
| Gross Resident Service Revenue | $ 50,009,717 | $ 48,224,093 |
| Less: Amortization of Advance Entrance Fee Revenue | (425,049) | (238,724) |
| Less: Contractual Adjustments and Allowances | (4,488,700) | (3,645,300) |
| Net Resident Service Revenue | $ 45,095,968 | $ 44,340,069 |

Provisions for estimated third-party payor settlements are provided in the period the related services are rendered. Differences between the amounts accrued and subsequent settlements are recorded in revenue in the year of settlement.

### Third-Party Reimbursement Agreements

#### Medicaid

The Corporation participates in the Medicaid program that is administered by the Texas Health and Human Services Commission. Skilled nursing centers that participate in the Medicaid program in the State of Texas are reimbursed based upon prospective rates. The Organization is required to file annual Medicaid cost reports which are subject to audit by the Texas Health and Human Services Commission. Adjustments to the report may prospectively affect payment rates.

#### Medicare

The Corporation participates in the Medicare program, which is reimbursed based on a Prospective Payment system (PPS). This program is administered by the Center for Medicare and Medicaid Services (CMS). The PPS is a per diem price based system. Annual cost reports are submitted to the designated intermediary; however, they do not contain a cost settlement.

## NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### Third-Party Reimbursement Agreements (Continued)

Nursing facilities licensed for participation in the Medicare and Medicaid programs are subject to annual surveys. If it is determined that a nursing facility is not in substantial compliance with the requirements of participation, CMS may impose sanctions and penalties during the period of noncompliance, which would have a negative impact on the revenues of the nursing facility.

The approximate percentage of rental revenue provided from Medicaid and Medicare reimbursement programs was 14% and 13% for the year ended December 31, 2016, respectively, and 12% and 15% for the year ended December 31, 2015, respectively.

Substantially all other net service revenue is generated from private payors (principally residents or the responsible party for the residents).

### Non-Operating Revenue

Unrestricted gifts, bequests, and investments earnings are included as non-operating revenue.

### Income Taxes

The Organization and the Foundation are nonprofit organizations classified as public charities and have been granted exempt status under Section 501(c)(3) of the Internal Revenue Code and applicable state codes.

The Organization and the Foundation's income tax returns are subject to review and examination by federal authorities. The Organization and the Foundation are not aware of any activities that would jeopardize their tax exempt status. The Organization and the Foundation is not aware of any activities that are subject to tax on unrelated business income or excise or other tax except for those that are already reported annually.

mmCare is a limited liability company and is not subject to income tax. Therefore, taxable income or loss is reported to the individual members for inclusion in their respective tax returns and no provision for federal and state income taxes has been recorded in the accompanying consolidated financial statements.

The accounting standard on accounting for uncertainty in income taxes addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the consolidated financial statements. Under that guidance, the Corporation may recognize the tax benefit from an uncertain tax position only if it is more likely than not, that the tax position will be sustained on examination by taxing authorities based on the technical merits of the position. Examples of tax positions include the tax-exempt status of the Organization and the Foundation and various positions related to the potential sources of unrelated business taxable income (UBIT). The tax benefits recognized in the consolidated financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. Management believes there are no unrecognized tax benefits identified or recorded as liabilities for the years ended December 31, 2016 and 2015.

## NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### Commitments and Contingencies

Liabilities for loss contingencies arising from claims, assessments, litigation, fines, penalties, and other sources are recorded when it is probable that a liability has been incurred and the amount can be reasonably estimated.

### Donated Assets and Services

Donated marketable securities and other non-cash donations are recorded at their estimated fair values at the date of donation. Generally no amounts are reflected in the consolidated financial statements for donated services. The Corporation generally pays for services requiring specific expertise. However, many individuals volunteer their time and perform various tasks to assist the residents of the Corporation's facilities. The Corporation receives more than 20,000 volunteer hours per year.

### Functional Allocation of Costs

The cost of providing the program and other activities has been summarized on a functional basis in the schedule of consolidated unrestricted functional expenses. Administrative expenses include both administrative and fundraising expenses and include those expenses that are not directly identifiable with any other specific function but provide for the overall support and direction of the Corporation. Accordingly, costs are allocated to the programs and administration based on actual use or estimated use, if actual use is not readily determinable. Included in administrative expenses on the consolidated statements of operations and changes in unrestricted net assets are fundraising expenses of $282,786 and $277,306 for the years ended December 31, 2016 and 2015, respectively.

### New Accounting Pronouncements

During the year ended December 31, 2016, the Corporation early adopted a provision of Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) 2016-01, *Financial Instruments – Overall: Recognition and Measurements of Financial Assets and Financial Liabilities*. This provision eliminates the requirement for entities, other than public business entities, to disclose the fair values of financial instruments carried at amortized cost, as previously required by Accounting Standards Codification (ASC) 825-10-50. As such, the Corporation has omitted this disclosure for the years ended December 31, 2016 and 2015. The early adoption of this provision did not have an impact on the Corporation's consolidated financial position or results of operations.

## NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### Reclassifications

Certain amounts in the 2015 consolidated financial statements have been reclassified to conform to the 2016 presentation for comparative purposes with no effect on previously reported decrease in net assets. Current portion of assets limited as to use has been reclassified by $2,026,563 to reflect the actual amount required to meet current liabilities at December 31, 2015 on the consolidated balance sheet. Total deferred entrance fees and resident deposits of $13,666,535 has been separated into the categories of resident deposits, refundable entrance fee payable and deferred revenue at December 31, 2015 on the consolidated balance sheet. Net assets released from restrictions at December 31, 2015 of $1,775,447 has been separated into net assets released from restrictions - operations of $829,939 and Net assets released from restrictions - capital of $945,508 on the consolidated statement of operations.

### Subsequent Events

In preparing these consolidated financial statements, the Corporation has evaluated events and transactions for potential recognition and disclosure through April 17, 2017, the date the consolidated financial statements were available to be issued (see Note 16).

## NOTE 3 ASSETS LIMITED AS TO USE

### Trustee Held Funds

The Corporation is required to hold funds in various accounts based upon terms in the indenture of trust of the Series 2013 bond issuances. These funds consist of the following:

Principal Account
Bond principal account has been established to service the required principal payments to bondholders.

Interest Account
Bond interest account has been established to service the required interest payments to bondholders.

Reserve Fund
The reserve fund has been established to provide a reserve for payment of principal and interest on the bonds in the event the Corporation's principal and interest payments are insufficient to meet debt service requirements.

## NOTE 3 ASSETS LIMITED AS TO USE (CONTINUED)

The assets limited as to use are included as follows on the consolidated balance sheets at December 31, 2016 and 2015:

| | 2016 | 2015 |
|---|---|---|
| **TRUSTEE HELD FUNDS** | | |
| Principal Account | $ 520,017 | $ 504,735 |
| Interest Account | 1,514,252 | 1,522,115 |
| Total Trustee Held Funds | 2,034,269 | 2,026,850 |
| **RESERVE FUND** | 3,548,238 | 3,548,238 |
| **ESCROW DEPOSITS - OVERLOOK ENTRANCES FEES** | - | 1,419,355 |
| **BOARD DESIGNATED FUNDS** | | |
| Cash and Cash Equivalents | 1,804,569 | 1,503,137 |
| Pooled Investment Funds | 16,592,893 | 15,489,658 |
| Due from Endowment and Temporarily Restricted | 2,181,408 | 1,997,808 |
| Total Board Designated Funds | 20,578,870 | 18,990,603 |
| **ENDOWMENT AND TEMPORARILY RESTRICTED INVESTMENTS** | | |
| Accrued Interest Receivable | 26,386 | 20,889 |
| Annuity Gifts Receivable | 8,829 | 9,051 |
| Beneficial Interest - Trusts | 7,208,511 | 7,071,352 |
| Cash and Cash Equivalents | 2,014,842 | 2,387,933 |
| Land and Property, Plant, and Equipment, Net | 2,974 | 2,974 |
| Pledge Receivables | 170,170 | 295,773 |
| Pooled Investment Funds | 10,441,334 | 9,550,738 |
| Due to Board-Designated Funds | (2,181,408) | (1,997,808) |
| Total Endowment and Temporarily Restricted Investments | 17,691,638 | 17,340,902 |
| Total Assets Limited as to Use | 43,853,015 | 43,325,948 |
| Less: Current Portion of Assets Limited as to Use | (2,033,988) | (2,026,563) |
| Assets Limited as to Use, Net of Current Portion | $ 41,819,027 | $ 41,299,385 |

## NOTE 3 ASSETS LIMITED AS TO USE (CONTINUED)

Assets limited as to use are invested in the following at December 31, 2016 and 2015:

| | December 31, 2016 | |
|---|---|---|
| | Fair Value | Cost |
| Cash and Cash Equivalents | $ 6,531,837 | $ 6,531,837 |
| Money Markets | 3,078,440 | 3,078,440 |
| Bonds | 7,578,888 | 7,653,108 |
| Common Stocks | 17,884,127 | 15,776,995 |
| Mutual Funds | 6,496,534 | 6,519,435 |
| Beneficial Interest in Perpetual Trust | 2,283,189 | 2,283,189 |
| Total Assets Limited as to Use | $ 43,853,015 | $ 41,843,004 |

| | December 31, 2015 | |
|---|---|---|
| | Fair Value | Cost |
| Cash and Cash Equivalents | $ 8,759,096 | $ 8,759,096 |
| Money Markets | 2,817,915 | 3,011,797 |
| Bonds | 6,889,678 | 6,863,467 |
| Common Stocks | 16,579,814 | 14,472,481 |
| Mutual Funds | 5,957,090 | 6,037,588 |
| Beneficial Interest in Perpetual Trust | 2,322,355 | 2,322,355 |
| Total Assets Limited as to Use | $ 43,325,948 | $ 41,466,784 |

The accumulated investment earnings of permanently and temporarily restricted investments, along with amounts of which the donor restriction has been fulfilled, are available for unrestricted use and are reflected above as due to board-designated funds. Absent donor restrictions, accumulated investment earnings on permanently restricted net assets are classified as temporarily restricted until they are spent and released to unrestricted net assets.

Investment income, gains, and losses for assets limited as to use, cash equivalents, and other investments are composed of the following for the years ended December 31, 2016 and 2015:

| | 2016 | 2015 |
|---|---|---|
| Interest and Dividend Income | $ 1,032,667 | $ 1,068,660 |
| Realized Gains on Sales of Securities | 2,166,168 | 730,367 |
| Unrealized Gains (Losses) on Marketable Securities | 159,054 | (1,801,544) |
| Investment Service Fees | (295,437) | (288,120) |
| Total | $ 3,062,452 | $ (290,637) |
| | | |
| Unrestricted Investment Earnings | 1,929,231 | (129,662) |
| Gain (Loss) on Endowment Investments | 1,133,221 | (160,975) |
| | $ 3,062,452 | $ (290,637) |

## NOTE 4 BENEFICIAL INTEREST IN TRUSTS

### Split Interest

The Corporation is a two-fifths income beneficiary of the Maida Davis Turtle Charitable Trust, which was established upon the death of the settlor. Four income beneficiaries are to be distributed a proportionate share of the net income of the trust annually. The trust will terminate the sooner of 50 years after the death of the settlor, or 21 years after the death of the last to die of the beneficiaries named in article III of the trust, at which time, forty percent of the remaining principal is to be distributed to the Foundation. A noncurrent asset for the beneficial interest in the trust has been recognized at fair value, based on quoted market prices, which totals $480,518 and $475,914 at December 31, 2016 and 2015, respectively. For the years ended December 31, 2016 and 2015, the Corporation received $20,832 and $24,186, respectively, in earnings distributions from the Trust.

The Corporation is a two percent income beneficiary of the Leon O. and Mary Jane K. Lewis Charitable fund. The Foundation's beneficial interest in the fund of $88,081 and $92,620 at December 31, 2016 and 2015, respectively, is recorded in endowment assets. For the years ended December 31, 2016 and 2015, the Corporation received $6,403 and $7,551, respectively, in earnings distributions from the Trust.

The Corporation is a one-third income beneficiary of the William C. and Verna Upton Alder Charitable Foundation, an irrevocable perpetual trust. In accordance with the trust agreement, the trustee shall distribute one-third of the trust's net income to the Corporation. The Corporation's beneficial interest in the trust of $1,979,051 and $2,019,742 at December 31, 2016 and 2015, respectively, is recorded in endowment assets. For the years ended December 31, 2016 and 2015, the Corporation received $152,645 and $56,958, respectively, in earnings distributions from the Trust.

The Corporation is a one-fifth income beneficiary of the Sears Benevolent Endowment Fund. The Corporation's beneficial interest in the fund at December 31, 2016 and 2015 is $208,856 and $202,714, respectively, which is recorded in endowment assets. For the year ended December 31, 2016, the Corporation received $7,078.

### Sole Beneficiary

The Corporation is the sole income beneficiary of the Chandler Memorial Home Trust, an irrevocable trust. In accordance with the Trust agreement, the Trustee shall distribute all Trust net income, exclusive of realized gains and losses, to the Corporation for the benefit of the Chandler campus. The Trustee may also distribute a portion of the Trust corpus to the Corporation if such distribution is determined to be reasonable and necessary by the Trustee. The Corporation's beneficial interest in the Trust of $4,444,804 and $4,273,084 at December 31, 2016 and 2015, respectively, is recorded in temporarily restricted assets. For the years ended December 31, 2016 and 2015, the Corporation received $52,718 and $62,267, respectively, in earnings distributions from the Trust for the benefit of the Chandler campus.

## NOTE 5 FAIR VALUE MEASUREMENTS

The Corporation categorizes its assets and liabilities measured at fair value into a three level hierarchy based on the priority of the inputs to the valuation technique used to determine fair value. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets and liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). If the inputs used in the determination of the fair value measurement fall within different levels of the hierarchy, the categorization is based on the lowest level input that is significant to the fair value measurement. Assets and liabilities valued at the fair value are categorized based on the inputs to the valuation techniques as follows:

*Level 1* – Inputs that utilize (unadjusted) quoted prices in active markets for identical assets or liabilities that the Corporation has the ability to access.

*Level 2* – Inputs that include quoted prices for similar assets and liabilities in active markets and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument. Fair values for these instruments are estimated using pricing models, quoted prices of securities with similar characteristics, or discounted cash flows.

*Level 3* – Inputs that are unobservable inputs for the asset or liability, which are typically based on an entity's own assumptions, as there is little, if any, related market activity.

Additionally, from time to time, the Corporation may be required to record at fair value other assets on a nonrecurring basis in accordance with generally accepted accounting principles. These adjustments to fair value usually result from the application of the lower-of-cost-or-market accounting or write down of individual assets. Nonfinancial assets measured at fair value on a nonrecurring basis would include nonfinancial assets and nonfinancial liabilities measured at fair value in the second step of a goodwill impairment test, other real estate owned, and other intangible assets measured at fair value for impairment assessment.

The Corporation also adopted the policy of valuing certain financial instruments at fair value. This accounting policy allows entities the irrevocable option to elect fair value for the initial and subsequent measurement for certain financial assets and liabilities on an instrument-by-instrument basis. The Corporation has not elected to measure any existing financial instruments at fair value, however, may elect to measure newly acquired financial instruments at fair value in the future.

## NOTE 5 FAIR VALUE MEASUREMENTS (CONTINUED)

The following tables present the fair value hierarchy for the Corporation measured at fair value on a recurring basis as of December 31, 2016 and 2015:

| | | 2016 | | |
|---|---|---|---|---|
| | Total | Level 1 | Level 2 | Level 3 |
| Assets: | | | | |
| Assets Limited as to Use: | | | | |
| Money Markets | $ 3,078,440 | $ 3,078,440 | $ - | $ - |
| Bonds | 7,578,888 | 7,578,888 | - | - |
| Common Stocks | 17,884,127 | 17,884,127 | - | - |
| Mutual Funds | 6,496,534 | 6,496,534 | - | - |
| Beneficial Interest in | | | | |
| Perpetual Trusts | 2,283,189 | - | - | 2,283,189 |
| Total Assets | $ 37,321,178 | $ 35,037,989 | $ - | $ 2,283,189 |

| | | 2015 | | |
|---|---|---|---|---|
| | Total | Level 1 | Level 2 | Level 3 |
| Assets: | | | | |
| Assets Limited as to Use: | | | | |
| Money Markets | $ 2,817,915 | $ 2,817,915 | $ - | $ - |
| Bonds | 6,889,678 | 6,889,678 | - | - |
| Common Stocks | 16,579,814 | 16,579,814 | - | - |
| Mutual Funds | 5,957,090 | 5,957,090 | - | - |
| Beneficial Interest in | | | | |
| Perpetual Trusts | 2,322,355 | - | - | 2,322,355 |
| Total Assets | $ 34,566,852 | $ 32,244,497 | $ - | $ 2,322,355 |

The following table presents changes in assets measured at fair value using Level 3 inputs on a recurring basis for the years ended December 31, 2016 and 2015:

| | 2016 | 2015 |
|---|---|---|
| Balance, Beginning of Year | $ 2,322,355 | $ 2,212,179 |
| Contributions | - | 202,707 |
| Income and Expenses, Net | 127,461 | (35,573) |
| Distributions | (166,627) | (56,958) |
| Balance, End of Year | $ 2,283,189 | $ 2,322,355 |

## NOTE 5 FAIR VALUE MEASUREMENTS (CONTINUED)

Assets limited as to use are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions, and other factors such as credit loss assumptions. Securities valued using Level 1 inputs include those traded on an active exchange, such as the New York Stock Exchange, as well as U.S. Treasury and other U.S. government and agency mortgage-backed securities that are traded by dealers or brokers in active over-the-counter markets.

Fair value for the contributions receivable from beneficial interests in perpetual trusts are measured using the Corporation's interest in the fair value of the assets held in the trusts as reported by the trustees as of December 31, 2016 and 2015. The Corporation considers the measurement of its beneficial interests in the trusts to be Level 3 measurements within the fair value hierarchy because even though the measurement is based on the unadjusted fair values of the trusts' assets reported by the trustee, the Corporation will never receive those assets or have the ability to direct the trustees to redeem them.

## NOTE 6 PLEDGE RECEIVABLES

Included in pledges receivable are amounts that comprise the following unconditional promises to give and conditional promises to give for which conditions have been substantially met at December 31, 2016 and 2015.

| | 2016 | 2015 |
|---|---|---|
| Receivable in Less than One Year | $ 170,170 | $ 245,773 |
| Receivable in One to Five Years | - | 50,000 |
| Total Pledge Receivable | $ 170,170 | $ 295,773 |

Pledges receivable are included in Endowment and Temporarily Restricted Investments in the consolidated balance sheets. No allowance for uncollectible pledges or discount has been recorded as all pledges receivable have been received subsequent to year-end.

## NOTE 7 PROPERTY, PLANT, AND EQUIPMENT

Property, plant, and equipment consist of the following at December 31, 2016 and 2015:

| | 2016 | 2015 |
|---|---|---|
| Land | $ 4,902,534 | $ 5,146,909 |
| Land Improvements | 5,211,363 | 4,215,520 |
| Buildings | 132,708,849 | 92,723,763 |
| Equipment and Furniture | 10,922,401 | 9,195,177 |
| Vehicles | 802,925 | 757,351 |
| Construction in Progress | 63,611 | 35,422,807 |
| Total | $ 154,611,683 | $ 147,461,527 |

Total depreciation expense for the years ended December 31, 2016 and 2015 was $5,146,843 and $3,981,546, respectively.

### Construction in Progress

In 2014, the Organization began a $42,000,000 expansion project at the Menger Springs campus related to the Overlook Independent Living and Cibolo Assisted Living facilities. This project was financed by the proceeds of the 2014 Construction Loan (see Note 8). The Overlook Independent Living expansion project was completed and the project was placed into service in February 2016. The Cibolo Assisted Living expansion project was completed and the project was placed into service in January 2016.

Construction in progress as of December 31, 2016 of $63,611 is related to various renovations and ongoing special projects.

### Interest Capitalization

Interest costs incurred, net of interest income earned, on borrowed funds during the period of construction of capital assets are capitalized as a component of the cost of acquiring those assets, and depreciated over the estimated useful lives by the straight-line method of depreciation. Interest, net of interest income, capitalized as part of the construction in progress totaled $72,129 and $312,704 for the years ended December 31, 2016 and 2015, respectively.

## NOTE 8 LONG-TERM DEBT

The Corporation's long-term debt at December 31, 2016 and 2015 is summarized below:

| | 2016 | 2015 |
|---|---|---|
| New Hope Cultural Revenue Bonds Series 2013 | $ 48,195,000 | $ 48,700,000 |
| New Hope Cultural Revenue Construction Loan 2014 | 30,000,000 | 34,675,896 |
| Subtotal | 78,195,000 | 83,375,896 |
| Unamortized Debt Issuance Costs | (2,574,304) | (2,749,015) |
| Total Long-Term Debt | 75,620,696 | 80,626,881 |
| Less: Current Maturities of Long-Term Debt | (1,110,888) | (505,000) |
| Long-Term Debt, Net | $ 74,509,808 | $ 80,121,881 |

Scheduled principal payments on long-term debt for the next five years and thereafter are as follows:

| Year Ending December 31, | Amount |
|---|---|
| 2017 | $ 1,110,888 |
| 2018 | 1,558,839 |
| 2019 | 1,587,740 |
| 2020 | 1,631,836 |
| 2021 | 1,671,125 |
| Thereafter | 70,634,572 |
| Total | $ 78,195,000 |

**New Hope Cultural Revenue Bonds Series 2013**

On September 19, 2013, the New Hope Cultural Education Facilities Corporation (Issuer) issued First Mortgage Revenue Bonds (Morningside Ministries Project) Series 2013 in the amount of $49,335,000 on behalf of the Organization with the proceeds used to (1) refund all of the outstanding Kendall County Health Facilities Development Corporation Variable Rate Demand Health Care Revenue Bonds (Morningside Ministries Project) Series 2008 and (2) to pay a portion of the cost of issuance of the Series 2013 bonds. The 2013 bonds are fixed rate bonds with the maturities and pricing as follows.

| Maturity (January 1,) | Principal Amount | Interest Rate |
|---|---|---|
| 2017 | $ 520,000 | 3.00% |
| 2018 | 535,000 | 3.25% |
| 2023 | 3,045,000 | 5.00% |
| 2033 | 9,375,000 | 6.25% |
| 2043 | 17,395,000 | 6.50% |
| 2048 | 17,325,000 | 6.50% |
| Total | $ 48,195,000 | |

## NOTE 8 LONG-TERM DEBT (CONTINUED)

The Issuer created and ordered established with U.S. Bank National Association (Bond Trustee) a trust fund (Bond Fund). There are two separate accounts within the Bond Fund designated as the Principal Account and the Interest Account, respectively. The Organization will deposit monthly 1/6 of the semi-annual interest payment into the Interest Account, and monthly 1/12 of the annual principal payment into the Principal Account. Additionally, the Issuer established with the Bond Trustee, a Debt Service Reserve Fund to be used to provide a reserve for the payment of principal and interest on the bonds. This Debt Service Reserve Fund was funded at issuance in the amount of $3,548,238, which is equal to the maximum annual debt service on the bonds. Additionally, the Series 2013 bonds are secured by certain bank accounts, property, plant, and equipment.

### Restrictive Covenants

Under the terms of the Series 2013 Bonds, the Organization is required to meet certain restrictive covenants related to the reporting and other financial and nonfinancial covenants. As of December 31, 2016, management was not aware of instances where the Organization was not in compliance with these covenants.

### New Hope Cultural Revenue Construction Loan 2014

On March 1, 2014, the Organization was issued a construction loan by BBVA Compass Bank. Advances are made pursuant to the Construction Loan Agreement, and can reach a maximum principal amount of $42,000,000. Repayment of this note shall be in 36 consecutive monthly interest only payments commencing on May 1, 2014. At the end of the interest only period, the loan shall not exceed $30,000,000. After this period, repayment shall be in 59 consecutive monthly principal and interest payments based on a 25-year amortization schedule, with a final payment of all outstanding principal and interest due at maturity on May 1, 2022. Interest on this note is charged at a variable rate based on 65% times the sum of one month LIBOR plus 1.90% (1.63% and 1.50% at December 31, 2016 and 2015, respectively). The construction loan is secured by certain bank accounts, property, plant, and equipment. On August 31, 2016, the Organization made a $12,000,000 principal payment with initial entrance fees from The Overlook.

## NOTE 9 TEMPORARILY AND PERMANENTLY RESTRICTED NET ASSETS

**Temporarily Restricted Net Assets**

Temporarily restricted net assets include gifts and contributions, which are restricted by the donors for specific purposes. Once the specific purposes are achieved, the temporarily restricted net assets are transferred to unrestricted net assets. Temporarily restricted net assets consist of the following at December 31, 2016 and 2015:

| | 2016 | 2015 |
|---|---|---|
| Endowment Earnings | $ 2,203,438 | $ 1,467,817 |
| Direct Charity Fund | 1,050 | 10,000 |
| Manor Unit #5 Renovation Fund | 98,865 | 435,315 |
| Special Projects Fund | 34,259 | 12,346 |
| Chandler Trust Fund | 2,350,612 | 2,350,612 |
| Maida Davis Turtle Trust | 469,175 | 469,175 |
| mmLearn.org Fund | 643,601 | 757,105 |
| Meadows Employee Fund | 9,000 | 12,000 |
| Total Temporarily Restricted Net Assets | $ 5,810,000 | $ 5,514,370 |

**Permanently Restricted Net Assets**

Permanently restricted net assets consist of contributions and gifts given for Covenant assistance and to provide for upkeep of the Meadows facility. The amounts are maintained in perpetuity. Interest and dividends on permanently restricted investments are used for Covenant assistance.

Permanently restricted net assets consisted of the following at December 31:

| | 2016 | 2015 |
|---|---|---|
| Covenant Fund | $ 7,491,640 | $ 7,436,532 |
| Kaulbach Fund | 3,390,000 | 3,390,000 |
| Meadows improvements | 1,000,000 | 1,000,000 |
| Total | $ 11,881,640 | $ 11,826,532 |

The Corporation has endowment funds to which donors have permanently restricted their contributions. According to the investment guidelines set forth by the Board of Directors of the Foundation, 3% of the underlying investment balances are available to be transferred to unrestricted funds on an annual basis. Transfers during the years ended December 31, 2016 and 2015 totaled $397,600 and $421,000, respectively.

## NOTE 9 TEMPORARILY AND PERMANENTLY RESTRICTED NET ASSETS (CONTINUED)

### Interpretation of Relevant Law

In July 2006, the Uniform Law Commission approved the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA) as a modernized version of the Uniform Management of Institutional Funds Act of 1972, the model act governing the investment and management of donor restricted endowment funds by not-for-profit organizations. Among its changes, UPMIFA prescribes guidelines for expenditure of a donor-restricted endowment funds, including Subsection 4(a) which states, "unless stated otherwise in the gift instrument, the assets in an endowment fund are donor restricted assets until appropriated for expenditure by the institution". The effective date of this new law began for fiscal years ending after December 15, 2008. As a result, certain amounts previously recorded in unrestricted net assets were reclassified to comply with the law.

Management has interpreted the State Prudent Management of Institutional Funds Act (SPMIFA) has required the preservation of fair value of the original gift as of the gift date of the donor restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Corporation reclassifies 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 fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Corporation in a manner consistent with the standard of prudence prescribed by SPMIFA. In accordance with SPMIFA, the Corporation considers the following in making a determination to appropriate or accumulate donor-restricted endowment funds:

- 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 Corporation
- The investment policies of the Corporation

The donor-restricted endowment net assets composition by type is comprised of the following at December 31:

| | 2016 | 2015 |
|---|---|---|
| Permanently Restricted Endowment Funds | $ 11,881,640 | $ 11,826,532 |
| Temporarily Restricted Endowment Funds | 2,203,438 | 1,467,817 |
| Total | $ 14,085,078 | $ 13,294,349 |

## NOTE 9 TEMPORARILY AND PERMANENTLY RESTRICTED NET ASSETS (CONTINUED)

### Interpretation of Relevant Law (Continued)

The Corporation had the following changes in endowment net assets during the years ended December 31, 2016 and 2015:

| | 2016 | 2015 |
|---|---|---|
| Investment Return: | | |
| Investment Income | $ 344,682 | $ 370,233 |
| Net Appreciation (Depreciation) | 898,558 | (423,524) |
| Contributions to Perpetual Endowment | 55,108 | 309,672 |
| Amounts Appropriated for Expenditures | (397,600) | (421,000) |
| Investment Fees | (110,019) | (107,686) |
| Total | $ 790,729 | $ (272,305) |

Description of amounts classified as permanently restricted net assets and temporarily restricted net assets (endowment only) is as follows at December 31, 2016 and 2015:

| | 2016 | 2015 |
|---|---|---|
| The Portion of Perpetual Endowment Funds that is Required to be Retained Permanently, Either by Explicit Donor Stipulation or by SPMIFA | $ 11,881,640 | $ 11,826,532 |
| The Portion of Perpetual Endowment Funds to a Time Restricted Under SPMIFA without Purpose Restrictions | $ 2,203,438 | $ 1,467,817 |

### Funds with Deficiencies

From time to time, the fair value of assets associated with individual donor-restricted funds may fall below the level that the donor or SPMIFA requires the Corporation to retain as a fund of perpetual duration. In accordance with accounting principles generally accepted in the United States of America, deficiencies of this nature are reported in unrestricted net assets until restored with future restricted investment gains.

### Return Objectives and Risk Parameters

The Corporation has adopted investment and spending policies for the endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the Corporation must hold in perpetuity or for a donor specific period(s), as well as Board designated funds. Under this policy, as approved by the board of directors, the endowment assets are invested in a manner that is intended to produce results that exceed the price and yield results of various market indexes while assuming a moderate level of investment risk. The Corporation expects its endowment funds, over time, to provide an average rate of return comparable to the benchmarks outlined in the investment policy. Actual returns in any given year may vary from these benchmarks.

## NOTE 9 TEMPORARILY AND PERMANENTLY RESTRICTED NET ASSETS (CONTINUED)

**Spending Policy and How the Investment Objective Relate to Spending Policy**

The Corporation has a policy of appropriating for distribution each year up to 3% of its year-end endowment fund fair value within the Corporation's control. In establishing this policy, the Corporation considers its long-term expected return on its endowments. Accordingly, over the long-term, the Corporation expects the current spending policy to allow its endowment to grow comparable to the benchmarks outlined in the investment policy. This is consistent with the Corporation's objective to maintain the purchasing power of the endowment assets in perpetuity or for a specified term, as well as to provide additional real growth through new gifts and investment return.

## NOTE 10 LEASE AND SERVICE AGREEMENTS

In September 2011, the Corporation entered into two separate Lease and Service Agreements covering approximately 9,436 square feet of space in one of its facilities. The tenants provide services that compliment the services provided by the Corporation. The agreements have a term of five years but either party can terminate the agreement with ninety (90) days prior written notice. In September 2016, both Lease and Service Agreements were renewed for another five years. During the terms of the agreements, the tenants pay no monetary rent to the Corporation, but pay the Corporation a total of $2,000 per month for housekeeping, repairs, maintenance, and utilities. The Corporation also received security deposits from these tenants totaling $2,000.

## NOTE 11 FINANCIAL ASSISTANCE AND CHARITY CARE

One of the purposes of the Corporation is to provide financial assistance to residents who may not otherwise be able to obtain services offered by the Corporation. Financial assistance is provided through the Covenant Assistance Program. Covenant financial assistance is based on "need" and is provided to residents who meet the need criteria established by management. The Corporation provided Covenant financial assistance during the years 2016 and 2015 in the amounts of $623,092 and $483,910, respectively. In connection with the Covenant financial assistance, interest and dividend income from investments of Covenant endowment net assets may be used to offset the cost of such assistance. In addition to the Covenant Assistance Program, donors are able to donate to a direct charity care fund to assist indigent residents.

The cost of charity care provided was approximately $5,250,000 and $4,225,000 in 2016 and 2015, respectively. The total cost estimate is based upon actual per patient day custodial care costs. The net cost of charity care was approximately $4,827,000 and $3,782,000 in 2016 and 2016, respectively. This is net of any restricted contributions and accumulated covenant fund income received and released to assist with such costs, which were approximately $423,000 in 2016 and $442,660 in 2015.

## NOTE 12 COMMITMENTS AND CONTINGENCIES

**Retirement Plan**

The Corporation has established a 401(k) pension plan, which covers substantially all eligible employees. For the calendar years 2016 and 2015, the Corporation matched 50% of employee voluntary contributions up to 4% of compensation. The Corporation's matching contributions for the years ended December 31, 2016 and 2015 totaled $251,815 and $240,300, respectively.

**Letters of Credit**

Texas Capital Bank has one letter of credit outstanding in connection with the Corporation's workers' compensation insurance program. This letter of credit, in the amount of $400,000, has been extended and covers claims through August 31, 2017 and it expires on that date. Texas Capital Bank has also issued a letter of credit that is outstanding and related to the Corporation's professional and general liability insurance program. This letter of credit, in the amount of $100,000 has been extended and covers claims through August 31, 2017 and it expires on that date.

**Unasserted Claims**

The Corporation is subject to various legal proceedings and claims which arise in the ordinary course of operations. In the opinion of management, the amount of any liability, if any, with respect to these actions would not materially affect the financial position or results of operations of the Corporation.

**Health Care**

The health care industry is subject to numerous laws and regulations by federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for resident services, and Medicare and Medicaid fraud and abuse. Recently, government activity has increased with respect to investigations by health care providers. Violations of these laws and regulations could result in expulsion from government health care programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management is not aware of any violations of these laws and regulations.

## NOTE 13 SALE OF MEDICAID BED LICENSES

In September 2016, the Corporation sold the Medicaid bed licenses at Chandler Health Care and Morningside Manor Health Care. The gain on sale in the amount of $1,515,000 has been reported in the consolidated statement of operations.

## NOTE 14 FUNDS HELD FOR OTHERS

The Corporation administers cash accounts on behalf of employees and residents and these accounts are not reflected in the consolidated financial statements. The accounts maintained on behalf of residents are subject to audit by governmental regulators.

## NOTE 15 SUBSEQUENT EVENTS

The Organization and the Foundation entered into an agreement and plan of merger of which the Foundation merged with the Organization and the Organization became the sole surving entity. The merger was effective December 31, 2016 at 11:59 p.m.

Effective February 1, 2017, the company agreement for mmCare was amended and the Organization now holds a 75% membership interest in mmCare. An unrelated party is the other 25% member and will be the management company.

Texas Health and Human Services Commission (TTHSC) implemented a Quality Incentive Payment Program (QIPP) to begin in September 2017 for non-state governmental owned nursing facilities. This program allows states to claim federal matching funds under Medicaid up to what Medicare would pay for a similar service. During 2017, the Organization sold their nursing home license at Morningside Manor Health Care and Chandler Health Care to Guadalupe Regional Medical Center in order to participate in this program.

## MORNINGSIDE MINISTRIES AND SUBSIDIARIES
## CONSOLIDATED SCHEDULE OF UNRESTRICTED FUNCTIONAL EXPENSES
## YEAR ENDED DECEMBER 31, 2016

| | Program Services | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Nursing | Food | Environmental | Ancillary | Life Enrichment | Training Institute & Other | Total Program Services | Administrative | Total |
| Salaries | $ 12,001,248 | $ 3,121,100 | $ 2,661,743 | $ 592,177 | $ 1,121,096 | $ 166,331 | $ 19,663,695 | $ 4,535,609 | $ 24,199,304 |
| Percentages | 49.59% | 12.90% | 11.00% | 2.45% | 4.63% | 0.69% | 81.26% | 18.74% | 100.00% |
| Employee Insurance and Payroll Taxes | 1,700,964 | 442,361 | 377,255 | 83,931 | 158,895 | 23,574 | 2,786,980 | 642,842 | 3,429,822 |
| Retirement Benefits | 124,884 | 32,478 | 27,698 | 6,162 | 11,666 | 1,731 | 204,618 | 47,197 | 251,815 |
| Total Salaries, Insurance Payroll Taxes and Benefits | 13,827,095 | 3,595,938 | 3,066,696 | 682,270 | 1,291,657 | 191,636 | 22,655,293 | 5,225,648 | 27,880,941 |
| Bank Fees | - | - | - | - | - | - | - | 4,700 | 4,700 |
| Bad Debt Expense | - | - | - | - | - | - | - | 536,534 | 536,534 |
| Development | - | - | - | - | - | - | - | 626,144 | 626,144 |
| Drugs | - | - | - | 3,607,603 | - | - | 3,607,603 | - | 3,607,603 |
| Dues and Subscriptions | - | - | - | - | - | 9 | 9 | 41,700 | 41,709 |
| Food | - | 2,165,557 | - | - | - | - | 2,165,557 | - | 2,165,557 |
| Insurance | - | - | - | - | - | 23,667 | 23,667 | 342,571 | 366,238 |
| Licenses | 1,080 | - | 13,715 | - | - | - | 14,795 | 12,729 | 27,524 |
| Medical Expenses | - | - | - | 511,600 | - | - | 511,600 | - | 511,600 |
| Other | - | - | - | 12,604 | - | 610 | 13,214 | 436,352 | 449,566 |
| Plant Operation and Maintenance | 37,702 | - | 549,179 | 77,582 | - | 197 | 664,660 | - | 664,660 |
| Postage | - | - | - | 29,194 | - | (20) | 29,174 | 26,707 | 55,881 |
| Professional Fees and Contract Services | 720,345 | - | 272,788 | 2,105,510 | - | 145,388 | 3,244,031 | 615,767 | 3,859,798 |
| Security | - | - | 75,219 | - | - | - | 75,219 | - | 75,219 |
| Staff Development | - | - | - | - | - | 26,008 | 26,008 | 192,656 | 218,664 |
| Supplies | 824,127 | 505,799 | 660,221 | 50,335 | 289,309 | 5,687 | 2,335,478 | 167,452 | 2,502,930 |
| Strategic Planning | - | - | - | - | - | - | - | 48,192 | 48,192 |
| Telephone | - | - | - | - | - | 2,010 | 2,010 | 71,404 | 73,414 |
| Travel | - | - | - | - | - | 1,732 | 1,732 | 43,709 | 45,441 |
| Utilities | - | - | 2,376,050 | - | - | - | 2,376,050 | - | 2,376,050 |
| Vehicle and Transportation | - | - | 51,560 | - | - | - | 51,560 | - | 51,560 |
| Total | 1,583,254 | 2,671,356 | 3,998,732 | 6,394,428 | 289,309 | 205,288 | 15,142,367 | 3,166,617 | 18,308,984 |
| Total Year Ended December 31, 2016 | $ 15,410,349 | $ 6,267,294 | $ 7,065,428 | $ 7,076,698 | $ 1,580,966 | $ 396,924 | $ 37,797,660 | $ 8,392,265 | $ 46,189,925 |

# MORNINGSIDE MINISTRIES AND SUBSIDIARIES
# CONSOLIDATED SCHEDULE OF UNRESTRICTED FUNCTIONAL EXPENSES
# YEAR ENDED DECEMBER 31, 2015

| | Program Services | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Nursing | Food | Environmental | Ancillary | Life Enrichment | Training Institute & Other | Total Program Services | Administrative | Total |
| Salaries | $ 11,129,411 | $ 2,670,437 | $ 2,311,552 | $ 528,988 | $ 1,073,578 | $ 168,079 | $ 17,882,045 | $ 4,308,936 | $ 22,190,981 |
| Percentages | 50.15% | 12.03% | 10.42% | 2.38% | 4.84% | 0.76% | 80.58% | 19.42% | 100.00% |
| Employee Insurance and Payroll Taxes | 1,645,834 | 394,803 | 341,966 | 78,107 | 158,840 | 24,942 | 2,644,492 | 637,330 | 3,281,822 |
| Retirement Benefits | 120,511 | 28,908 | 25,039 | 5,719 | 11,631 | 1,826 | 193,634 | 46,666 | 240,300 |
| Total Salaries, Insurance Payroll Taxes and Benefits | 12,895,756 | 3,094,148 | 2,678,557 | 612,814 | 1,244,049 | 194,847 | 20,720,171 | 4,992,932 | 25,713,103 |
| Bank Fees | - | - | - | - | - | - | - | 4,700 | 4,700 |
| Bad Debt Expense | - | - | - | - | - | - | - | 84,953 | 84,953 |
| Development | - | - | - | - | - | 63,131 | 63,131 | 585,622 | 648,753 |
| Drugs | - | - | - | 3,750,079 | - | - | 3,750,079 | - | 3,750,079 |
| Dues and Subscriptions | - | - | - | - | - | 1,230 | 1,230 | 51,576 | 52,806 |
| Food | - | 2,037,826 | - | - | - | - | 2,037,826 | - | 2,037,826 |
| Insurance | - | - | - | - | - | 9,435 | 9,435 | 449,480 | 458,915 |
| Licenses | 1,755 | - | 14,410 | - | - | - | 16,165 | 16,929 | 33,094 |
| Medical Expenses | - | - | - | 655,113 | - | - | 655,113 | - | 655,113 |
| Other | - | - | - | 8,171 | - | 12,565 | 20,736 | 444,277 | 465,013 |
| Plant Operation and Maintenance | 65,277 | - | 608,806 | 86,690 | - | 2,004 | 762,777 | - | 762,777 |
| Postage | - | - | - | 27,018 | - | - | 27,018 | 17,846 | 44,864 |
| Professional Fees and Contract Services | 280,158 | 12,037 | 224,799 | 2,300,870 | - | 147,342 | 2,965,206 | 500,897 | 3,466,103 |
| Security | - | - | 79,273 | - | - | - | 79,273 | - | 79,273 |
| Staff Development | - | - | - | - | - | 10,132 | 10,132 | 219,798 | 229,930 |
| Supplies | 961,619 | 425,440 | 633,527 | 48,805 | 256,094 | 33,651 | 2,359,136 | 185,790 | 2,544,926 |
| Strategic Planning | - | - | - | - | - | - | - | 14,912 | 14,912 |
| Telephone | - | - | - | - | - | 1,786 | 1,786 | 86,439 | 88,225 |
| Travel | - | - | - | - | - | 2,188 | 2,188 | 54,181 | 56,369 |
| Utilities | - | - | 2,166,969 | - | - | - | 2,166,969 | - | 2,166,969 |
| Vehicle and Transportation | - | - | 57,250 | - | - | - | 57,250 | - | 57,250 |
| Total | 1,308,809 | 2,475,303 | 3,785,034 | 6,876,746 | 256,094 | 283,464 | 14,985,450 | 2,717,400 | 17,702,850 |
| Total Year Ended December 31, 2015 | $ 14,204,565 | $ 5,569,451 | $ 6,463,591 | $ 7,489,560 | $ 1,500,143 | $ 478,311 | $ 35,705,621 | $ 7,710,332 | $ 43,415,953 |

# MORNINGSIDE MINISTRIES AND SUBSIDIARIES
# CONSOLIDATING BALANCE SHEETS
# DECEMBER 31, 2016

| ASSETS | Morningside Ministries | Ministries Foundation | Eliminations | Group Sub-Total | mmCare, LLC | Eliminations | Total |
|---|---|---|---|---|---|---|---|
| **CURRENT ASSETS** | | | | | | | |
| Cash and Cash Equivalents | $ 8,435,316 | $ 965,878 | $ - | $ 9,401,194 | $ - | $ - | $ 9,401,194 |
| Resident Accounts Receivable, Net | 3,107,760 | - | - | 3,107,760 | - | - | 3,107,760 |
| Accounts Receivable, Other | - | 43,371 | - | 43,371 | - | - | 43,371 |
| Current Portion of Assets Limited as to Use | 2,033,988 | - | - | 2,033,988 | - | - | 2,033,988 |
| Supplies | 428,511 | - | - | 428,511 | - | - | 428,511 |
| Prepaid Expenses | 447,825 | 3,680 | - | 451,505 | - | - | 451,505 |
| Total Current Assets | 14,453,400 | 1,012,929 | - | 15,466,329 | - | - | 15,466,329 |
| **ASSETS LIMITED AS TO USE** | | | | | | | |
| Cash and Cash Equivalents - Trustee Held | 2,034,269 | - | - | 2,034,269 | - | - | 2,034,269 |
| Reserve Fund | 3,548,238 | - | - | 3,548,238 | - | - | 3,548,238 |
| Escrow Deposits - Overlook Entrance Fees | - | - | - | - | - | - | - |
| Board Designated Funds | 1,496,874 | 19,081,996 | - | 20,578,870 | - | - | 20,578,870 |
| Endowment and Temporarily Restricted Investments | - | 17,691,638 | - | 17,691,638 | - | - | 17,691,638 |
| Total Assets Limited as to Use | 7,079,381 | 36,773,634 | - | 43,853,015 | - | - | 43,853,015 |
| Less: Current Portion of Assets Limited as to Use | (2,033,988) | - | - | (2,033,988) | - | - | (2,033,988) |
| Total Assets Limited as to Use, Net of Current Portion | 5,045,393 | 36,773,634 | - | 41,819,027 | - | - | 41,819,027 |
| **PROPERTY, PLANT, AND EQUIPMENT** | 11,755,347 | 142,856,336 | - | 154,611,683 | - | - | 154,611,683 |
| Less: Accumulated Depreciation | (7,644,797) | (52,097,337) | - | (59,742,134) | - | - | (59,742,134) |
| Property, Plant, and Equipment, Net | 4,110,550 | 90,758,999 | - | 94,869,549 | - | - | 94,869,549 |
| **OTHER ASSETS** | | | | | | | |
| Due From (To) Affiliates | 5,569 | (5,569) | - | - | - | - | - |
| Investment in Foundation | 128,528,993 | - | (128,528,993) | - | - | - | - |
| Investment in mmCare, LLC | 283,628 | - | - | 283,628 | - | (283,628) | - |
| Deposits | 70,000 | - | - | 70,000 | - | - | 70,000 |
| Other Assets | 20,800 | - | - | 20,800 | 283,628 | - | 304,428 |
| Total Other Assets | 128,908,990 | (5,569) | (128,528,993) | 374,428 | 283,628 | (283,628) | 374,428 |
| Total Assets | $ 152,518,333 | $ 128,539,993 | $ (128,528,993) | $ 152,529,333 | $ 283,628 | $ (283,628) | $ 152,529,333 |

# MORNINGSIDE MINISTRIES AND SUBSIDIARIES
# CONSOLIDATING BALANCE SHEETS (CONTINUED)
# DECEMBER 31, 2016

| LIABILITIES AND NET ASSETS | Morningside Ministries | Morningside Ministries Foundation | Eliminations | Obligated Group Sub-Total | mmCare, LLC | Eliminations | Total |
|---|---|---|---|---|---|---|---|
| **CURRENT LIABILITIES** | | | | | | | |
| Current Maturities of Long-Term Debt | $ 1,110,888 | $ - | $ - | $ 1,110,888 | $ - | $ - | $ 1,110,888 |
| Accounts Payable | 1,089,771 | - | - | 1,089,771 | - | - | 1,089,771 |
| Accrued Wages and Related Costs | 1,365,275 | - | - | 1,365,275 | - | - | 1,365,275 |
| Accrued Insurance Cost | 111,000 | - | - | 111,000 | - | - | 111,000 |
| Accrued Interest Payable | 1,513,988 | - | - | 1,513,988 | - | - | 1,513,988 |
| Accrued Expenses | 76,197 | 11,000 | - | 87,197 | - | - | 87,197 |
| Total Current Liabilities | 5,267,119 | 11,000 | - | 5,278,119 | - | - | 5,278,119 |
| **LONG-TERM LIABILITIES** | | | | | | | |
| Resident Deposits | 114,872 | - | - | 114,872 | - | - | 114,872 |
| Refundable Entrance Fee Payable | 24,092,874 | - | - | 24,092,874 | - | - | 24,092,874 |
| Deferred Revenue | 3,747,153 | - | - | 3,747,153 | - | - | 3,747,153 |
| Long-Term Debt | 74,509,808 | - | - | 74,509,808 | - | - | 74,509,808 |
| Total Long-Term Liabilities | 102,464,707 | - | - | 102,464,707 | - | - | 102,464,707 |
| Total Liabilities | 107,731,826 | 11,000 | - | 107,742,826 | - | - | 107,742,826 |
| **NET ASSETS** | | | | | | | |
| Unrestricted | 27,094,867 | 110,837,353 | (110,837,353) | 27,094,867 | 283,628 | (283,628) | 27,094,867 |
| Temporarily Restricted | 5,810,000 | 5,810,000 | (5,810,000) | 5,810,000 | - | - | 5,810,000 |
| Permanently Restricted | 11,881,640 | 11,881,640 | (11,881,640) | 11,881,640 | - | - | 11,881,640 |
| Total Net Assets | 44,786,507 | 128,528,993 | (128,528,993) | 44,786,507 | 283,628 | (283,628) | 44,786,507 |
| Total Liabilities and Net Assets | $ 152,518,333 | $ 128,539,993 | $ (128,528,993) | $ 152,529,333 | $ 283,628 | $ (283,628) | $ 152,529,333 |

## MORNINGSIDE MINISTRIES AND SUBSIDIARIES
## CONSOLIDATING STATEMENTS OF OPERATIONS
## YEAR ENDED DECEMBER 31, 2016

| | Morningside Ministries | Morningside Ministries Foundation | Eliminations | Obligated Group Sub-Total | mmCare, LLC | Eliminations | Total |
|---|---|---|---|---|---|---|---|
| **OPERATING REVENUE** | | | | | | | |
| Net Resident Service Revenue | $ 45,095,968 | $ - | $ - | $ 45,095,968 | $ - | $ - | $ 45,095,968 |
| Amortization of Advance Entrance Fee Revenue | 425,049 | - | - | 425,049 | - | - | 425,049 |
| Other Operating Revenue | 5,400,178 | 12,438 | (4,362,000) | 1,050,616 | - | - | 1,050,616 |
| Net Assets Released from Restrictions - Operations | - | 801,575 | - | 801,575 | - | - | 801,575 |
| Total Operating Revenue | 50,921,195 | 814,013 | (4,362,000) | 47,373,208 | - | - | 47,373,208 |
| **OPERATING EXPENSES** | | | | | | | |
| Program Services: | | | | | | | |
| Nursing Services | 15,410,349 | - | - | 15,410,349 | - | - | 15,410,349 |
| Food Services | 6,267,294 | - | - | 6,267,294 | - | - | 6,267,294 |
| Environmental Services | 7,065,428 | - | - | 7,065,428 | - | - | 7,065,428 |
| Ancillary Services | 7,076,698 | - | - | 7,076,698 | - | - | 7,076,698 |
| Life Enrichment | 1,580,966 | - | - | 1,580,966 | - | - | 1,580,966 |
| Training Institutes and Other | 396,924 | - | - | 396,924 | - | - | 396,924 |
| Total Program Services | 37,797,660 | - | - | 37,797,660 | - | - | 37,797,660 |
| Administrative Expenses | 12,621,534 | 132,731 | (4,362,000) | 8,392,265 | - | - | 8,392,265 |
| Depreciation | 698,913 | 4,447,930 | - | 5,146,843 | - | - | 5,146,843 |
| Interest | 3,710,160 | - | - | 3,710,160 | - | - | 3,710,160 |
| Total Operating Expenses | 54,828,267 | 4,580,661 | (4,362,000) | 55,046,928 | - | - | 55,046,928 |
| **NET LOSS FROM OPERATIONS** | (3,907,072) | (3,766,648) | - | (7,673,720) | - | - | (7,673,720) |
| **OTHER INCOME (EXPENSE)** | | | | | | | |
| Unrestricted Investment Earnings | 153,661 | 1,775,570 | - | 1,929,231 | - | - | 1,929,231 |
| Unrestricted Contributions | - | 191,093 | - | 191,093 | - | - | 191,093 |
| Loss on Sale of Property and Equipment | (309) | (2,023) | - | (2,332) | - | - | (2,332) |
| Gain on Sale of Medicaid Bed Licenses | 1,515,000 | - | - | 1,515,000 | - | - | 1,515,000 |
| Total Other Income | 1,668,352 | 1,964,640 | - | 3,632,992 | - | - | 3,632,992 |
| **DEFICIT OF REVENUES OVER EXPENSES** | (2,238,720) | (1,802,008) | - | (4,040,728) | - | - | (4,040,728) |
| Equity Transfer | (39,829,058) | 39,545,430 | - | (283,628) | 283,628 | - | - |
| Change in Investment in Foundation | 38,120,648 | - | (38,120,648) | - | - | - | - |
| Change in Investment in mmCare, LLC | 283,628 | - | - | 283,628 | - | (283,628) | - |
| Net Assets Released from Restrictions - Capital | - | 377,226 | - | 377,226 | - | - | 377,226 |
| **INCREASE (DECREASE) IN UNRESTRICTED NET ASSETS** | $ (3,663,502) | $ 38,120,648 | $ (38,120,648) | $ (3,663,502) | $ 283,628 | $ (283,628) | $ (3,663,502) |

**MORNINGSIDE MINISTRIES AND SUBSIDIARIES**
**CONSOLIDATING STATEMENTS OF CHANGES IN NET ASSETS**
**YEAR ENDED DECEMBER 31, 2016**

| | Morningside Ministries | Morningside Ministries Foundation | Eliminations | Obligated Group Sub-Total | mmCare, LLC | Eliminations | Total |
|---|---|---|---|---|---|---|---|
| **UNRESTRICTED NET ASSETS** | | | | | | | |
| Deficit of Revenues over Expenses | $ (2,238,720) | $ (1,802,008) | $ - | $ (4,040,728) | $ - | $ - | $ (4,040,728) |
| Equity Transfer | (39,829,058) | 39,545,430 | - | (283,628) | 283,628 | - | - |
| Change in Investment in Foundation | 38,120,648 | - | (38,120,648) | - | - | - | - |
| Change in Investment in mmCare, LLC | 283,628 | - | - | 283,628 | - | (283,628) | - |
| Net Assets Released from Restrictions - Capital | - | 377,226 | - | 377,226 | - | - | 377,226 |
| Increase (Decrease) in Unrestricted Net Assets | (3,663,502) | 38,120,648 | (38,120,648) | (3,663,502) | 283,628 | (283,628) | (3,663,502) |
| **TEMPORARILY RESTRICTED NET ASSETS** | | | | | | | |
| Contributions | - | 341,210 | - | 341,210 | - | - | 341,210 |
| Gain on Endowment Investments | - | 1,133,221 | - | 1,133,221 | - | - | 1,133,221 |
| Net Assets Released from Restrictions - Operations | - | (801,575) | - | (801,575) | - | - | (801,575) |
| Net Assets Released from Restrictions - Capital | - | (377,226) | - | (377,226) | - | - | (377,226) |
| Change in Investment in Foundation | 295,630 | - | (295,630) | - | - | - | - |
| Increase in Temporarily Restricted Net Assets | 295,630 | 295,630 | (295,630) | 295,630 | - | - | 295,630 |
| **PERMANENTLY RESTRICTED NET ASSETS** | | | | | | | |
| Contributions | - | 55,108 | - | 55,108 | - | - | 55,108 |
| Change in Investment in Foundation | 55,108 | - | (55,108) | - | - | - | - |
| Increase in Permanently Restricted Net Assets | 55,108 | 55,108 | (55,108) | 55,108 | - | - | 55,108 |
| **INCREASE (DECREASE) IN NET ASSETS** | (3,312,764) | 38,471,386 | (38,471,386) | (3,312,764) | 283,628 | (283,628) | (3,312,764) |
| Net Assets - Beginning of Year | 48,099,271 | 87,619,062 | (87,619,062) | 48,099,271 | - | - | 48,099,271 |
| **NET ASSETS - END OF YEAR** | $ 44,786,507 | $ 126,090,448 | $ (126,090,448) | $ 44,786,507 | $ 283,628 | $ (283,628) | $ 44,786,507 |