The Episcopal Church Home, Inc.

Financial Report
December 31, 2017

Contents

Independent Auditor's Report

Board of Directors
The Episcopal Church Home, Inc.

Report on the Financial Statements
We have audited the accompanying financial statements of The Episcopal Church Home, Inc., which comprise the balance sheet as of December 31, 2017, the related statements of activities, changes in net assets, and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements
Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility
Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Episcopal Church Home, Inc. as of December 31, 2017, and the results of its activities, 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.

RSM US LLP

Cincinnati, Ohio
June 29, 2018

The Episcopal Church Home, Inc.

Balance Sheet
December 31, 2017

Assets	
Current assets:	
Cash and cash equivalents	$ 2,171,452
Resident accounts receivable, net (Note 2)	1,254,222
Prepaid expenses	203,815
Other assets	21,347
Investments and assets limited as to use (Note 3)	41,579
Total current assets	3,692,415
Due from financially interrelated Foundation	111,582
Property and equipment, net (Note 4)	18,008,506
Investments and assets limited as to use, less current portion (Note 3)	1,002,734
Interest in net assets of financially interrelated Foundation (Note 10)	8,323,718
Total assets	$ 31,138,955
Liabilities and Net Assets	
Current liabilities:	
Current maturities of long-term debt (Note 5)	$ 1,586,841
Accounts payable	969,206
Accrued expenses and other liabilities	824,731
Refundable advance deposits	950,000
Deferred entrance fees	409,000
Total current liabilities	4,739,778
Long-term debt, less current maturities (Note 5)	8,653
Refundable advance deposits, less current portion	10,805,366
Deferred entrance fees, less current portion	1,304,705
Total liabilities	16,858,502
Net assets:	
Unrestricted	5,915,157
Temporarily restricted	5,768,880
Permanently restricted (Note 10)	2,596,416
Total net assets	14,280,453
Total liabilities and net assets	$ 31,138,955

See notes to financial statements.

The Episcopal Church Home, Inc.

Statement of Activities
Year Ended December 31, 2017

Operating revenue:	
Net resident service revenue	$ 17,372,989
Amortization of entrance fees	386,735
Other operating revenue	311,481
Endowment income from financially interrelated Foundation	273,256
Total operating revenue	18,344,461
Operating expenses:	
Salaries and wages	7,069,129
Employee benefits and payroll taxes	2,261,530
Marketing	311,484
Supplies	1,040,900
Food	801,047
Professional and purchased services	4,907,067
Utilities	701,026
Insurance	231,943
Depreciation and amortization	1,472,578
Interest	51,649
Bad debt expense	185,908
Other operating expenses	897,323
Total operating expenses	19,931,584
Operating loss	(1,587,123)
Nonoperating income:	
Contributions	580,013
Investment income	5,503
Total nonoperating income	585,516
Deficit of revenues over expenses	$ (1,001,607)

See notes to financial statements.

The Episcopal Church Home, Inc.

Statement of Changes in Net Assets
Year Ended December 31, 2017

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Balance, January 1, 2017	$ 6,867,955	$ 5,159,429	$ 2,286,570	$ 14,313,954
Deficit of revenues over expenses	(1,001,607)	-	-	(1,001,607)
Transfers to financially interrelated foundation (Note 10)	-	(259,066)	(42,516)	(301,582)
Change in net assets of financially interrelated Foundation (Note 10)	-	917,326	352,362	1,269,688
Net assets released from restrictions - used for capital	48,809	(48,809)	-	-
Change in net assets	(952,798)	609,451	309,846	(33,501)
Balance, December 31, 2017	$ 5,915,157	$ 5,768,880	$ 2,596,416	$ 14,280,453

See notes to financial statements.

The Episcopal Church Home, Inc.

Statement of Cash Flows
Year Ended December 31, 2017

Cash flows from operating activities:	
Change in net assets	$ (33,501)
Adjustments to reconcile change in net assets to net cash used in operating activities:	
Depreciation and amortization	1,472,578
Gain on sales of assets	(525)
Provision for bad debt expense	185,908
Amortization of entrance fees	(386,735)
Investment income	(1,567)
Change in net assets of financially interrelated Foundation	(1,269,688)
Change in operating assets and liabilities:	
Resident accounts receivable	(235,209)
Due from financially interrelated Foundation	(111,582)
Prepaid expenses and other assets	(5,776)
Accounts payable	(61,418)
Other liabilities	270,255
Net cash used in operating activities	(177,260)
Cash flows from investing activities:	
Purchase of property and equipment	(703,856)
Proceeds from sale assets	525
Purchase of investments	(1,996,499)
Sales and maturities of investments	1,151,222
Net cash used in investing activities	(1,548,608)
Cash flows from financing activities:	
Entrance fees collected	1,137,699
Entrance fees refunded	(1,161,455)
Principal payments on long-term debt	(339,866)
Net cash used in financing activities	(363,622)
Net change in cash and cash equivalents	(2,089,490)
Cash and cash equivalents:	
Beginning	4,260,942
Ending	$ 2,171,452
Supplemental disclosure of cash flow information:	
Cash paid during the year for interest	$ 52,254
Supplemental noncash investing activities:	
Transfer of investments to interest in financially interrelated Foundation	$ 301,582

See notes to financial statements.

Note 1. Organization and Summary of Significant Accounting Policies

Nature of operations: The Episcopal Church Home, Inc. (the Organization) is a Kentucky nonprofit organization located in Louisville, Kentucky. The Organization operates a senior residential health care facility and home known as the Episcopal Church Home (the Home). The Home has licenses to operate up to 93 skilled nursing facility beds, 46 nursing home beds, and 127 personal care beds, 52 of which are located in a designated special care unit for memory-impaired persons. St. Luke's Chapel is located adjacent to the Home and its accounts and activities are included with those of the Home. The Organization also owns and operates Dudley Square, an independent living retirement community consisting of 62 townhouses on a site adjacent to the Home. Residents of Dudley Square have lifetime occupancy rights in return for payment of residency fees including advance entrance fees that are partially refundable.

Basis of presentation: The accompanying financial statements are prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) in accordance with the Financial Accounting Standards Board (FASB) Accounting Standards Codification.

Use of estimates: The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported amounts of revenue and expense during the reporting period. Actual results could differ from those estimates.

Tax status: The Organization is a nonprofit organization as described in Section 501(c)(3) of the Internal Revenue Code and therefore is not subject to income taxes. Accounting principles generally accepted in the United States of America require management to evaluate tax positions taken by the Organization and recognize a tax liability if the Organization has taken an uncertain position that more likely than not would not be sustained upon examination by the IRS or other applicable taxing authorities. The Organization is no longer subject to income tax examinations for fiscal years prior to 2014.

Compliance: The Organization is affected by the health care economy in the State of Kentucky and is subject to local, state, and federal rules and regulations. Compliance with these laws and regulations, particularly those relating to the Medicare and Medicaid programs, can be subject to government review and interpretation, as well as regulatory actions unknown and unasserted at this time. Violations of these regulations could result in the imposition of significant fines and penalties, as well as significant repayments of previously billed and collected revenue for resident services. Management believes that the Organization is in substantial compliance with current laws and regulations.

Interests in financially interrelated entities: A recipient entity and a specified beneficiary are financially interrelated entities if one of the entities has the ability to influence the operating and financial decisions of the other and one of the entities has an ongoing economic interest in the net assets of the other. On October 1, 2016, as a result of the Affiliation (Note 10), The Episcopal Church Home Foundation, Inc. (the Foundation) was established and certain investments were transferred from the Organization to the Foundation. The Foundation was established for the sole purpose to support the Organization through fund-raising and investment activities. As such, the Organization has an ongoing and residual right to the Foundation’s net assets. The Organization recognizes and adjusts its interest in the net assets of the Foundation based on the fair value of the Foundation’s underlying net assets, as reflected in the accompanying financial statements.

Cash and cash equivalents: Cash equivalents include all highly liquid investments with original maturities of three months or less. Deposits in banks at times may exceed federally insured limits.

Note 1. Organization and Summary of Significant Accounting Policies (Continued)

Resident accounts receivable: Resident accounts receivable consists of amounts due from residents and third-party payors, less an estimate for uncollectible accounts. The allowance for uncollectible accounts is established on an aggregate basis by using historical write-off rate factors applied to unpaid accounts based on aging. Loss rate factors are based on historical loss experience and adjusted for economic conditions and other trends affecting the Organization's ability to collect outstanding amounts. Uncollectible amounts are written off against the allowance for doubtful accounts in the period they are determined to be uncollectible. See Note 2.

Net resident service revenue: Net resident service revenue includes rent, room charges and ancillary services and is derived from participation in the Medicare and Medicaid programs, as well as from insurance companies and private pay residents. Revenue is considered earned when services are provided and is recorded at established billing rates, net of contractual adjustments resulting from the agreements with third-party payors, if applicable.

The Home participates in the Medicare and Medicaid programs for qualified residents. The payment methodology related to these programs is based on cost and clinical assessments that are subject to review and final approval by Medicare and Medicaid. Provisions for estimated third-party payor settlements, if any, are provided in the period the related services are rendered. Differences between the amounts accrued and the subsequent settlements are recorded into operations in the year of settlement.

The Home is paid under the Medicare Prospective Payment System (PPS) which is a per diem price-based system. Annual cost reports are required to be submitted to the designated Medicare Administrative Contractor; however, they do not contain a cost settlement. The Home is paid under the Medicaid program administered by the State of Kentucky. The Home bills the program using rates established by the State of Kentucky, based on a pricing fee methodology with adjustments based on acuity and geographic location. Such rates are subject to prospective adjustment by the State of Kentucky on a quarterly basis.

Amounts earned under the Medicaid and Medicare programs make up a significant portion of net resident service revenue earned during the year ended December 31, 2017 are as follows:

Medicare	27%
Medicaid	7%

Charity care: The Organization provides care to residents who meet certain criteria under its charity care policy without charge. Key elements used to determine eligibility include a resident's demonstrated inability to pay. Because the Organization does not pursue collection of amounts determined to qualify for financial assistance, they are not reported as revenue. The Organization has estimated the costs foregone for services and supplies furnished under the Organization's charity care policy aggregated to approximately $65,000 for the year ended December 31, 2017.

Performance indicator: The statement of activities includes a performance indicator of operations labeled as “operating loss.” Changes in net assets which are excluded from the performance indicator typically include the transfers to and changes in net assets of interrelated Foundation, contributions, investment income.

Note 1. Organization and Summary of Significant Accounting Policies (Continued)

Contributions: Contributions received are recorded as an increase in unrestricted, temporarily restricted or permanently restricted support, depending on the existence or nature of any donor-imposed restrictions.

Net assets: Net assets of the Organization and changes therein are classified and reported as follows:

Unrestricted: Those resources not subject to donor imposed restrictions over which the Board of Directors has discretionary control.

Temporarily restricted: Those resources subject to donor imposed restrictions which will be satisfied by specific actions of the Organization and/or by the passage of time. A portion of the interest in the financially interrelated Foundation is also reported as temporarily restricted.

Permanently restricted: Those resources are subject to a donor imposed restriction that they be maintained permanently by the Organization. The donors of these resources generally permit the Organization to use all or part of the income earned, including capital appreciation for unrestricted or temporarily restricted purposes.

Unconditional promises to give cash and other assets are accrued at estimated fair 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. Contributions received with donor-imposed restrictions, where the restrictions are met in the same fiscal year, are reported as unrestricted net assets.

Investments: Investments are considered trading securities and are carried at fair value with unrealized gains or losses included in the statement of activities unless the investment income is restricted by donor or law. Contributed investments are recorded at fair value on the date of the gift. Realized gains or losses on investments sold are determined on a specific identification basis.

Assets limited as to use: Assets limited to use consist of cash and cash equivalents and are limited as to use and include certain amounts internally designated as limited by the Board of Directors.

Property and equipment: Property and equipment are recorded at cost if purchased, or fair market value as of the date of donation, and depreciated over their estimated useful lives using the straight-line method of depreciation. Estimated useful lives are as follows:

Land improvements	10-20 years
Buildings and improvements	10-40 years
Furniture, fixtures and equipment	5-10 years
Vehicles	5 years

Note 1. Organization and Summary of Significant Accounting Policies (Continued)

Property and equipment is subject to an impairment assessment whenever events or circumstances indicate that the carrying amount of an asset, or group of assets, may not be recoverable from future cash flows. If the carrying amount is considered impaired, an impairment charge is recorded for the amount by which the carrying value exceeds its fair value. Management has concluded that no events or circumstances indicating potential impairment occurred for the year ended December 31, 2017.

Refundable advance deposits and deferred entrance fees: Residents entering into a Dudley Square independent living unit are required to execute a resident agreement. The agreements require the residents to pay an entrance fee prior to occupancy. The agreements stipulate that a portion of the entrance fee is partially refundable within 90 days after the death of the resident, permanent transfer of the resident out of the Dudley Square units to other units of the Home or another organization, or termination of the agreement by the resident. For agreements entered into subsequent to July 1, 2006, the residency fee is refundable, less 1% for each month of occupancy, up to 25%, for a minimum refund of 75%. For agreements entered into prior to July 1, 2006, the minimum refund is 82%.

The refundable portion of the entrance fees is reported as “Refundable advance deposits” in the accompanying balance sheet with a portion classified as a current liability based on the Organization’s prior experience with refund requests.

The nonrefundable portion of the entrance fees is reported as “Deferred entrance fees” in the accompanying balance sheet with a portion classified as a current liability based on estimates of amounts expected to be amortized to revenue in the next fiscal year. The nonrefundable portion of the deferred entrance fee is amortized to revenue using the straight-line method over the estimated remaining useful life expectancy of the residents. Any unamortized entrance fees at the time of the resident's death are recorded as revenue.

The agreements require the residents to pay a monthly service charge for services provided and use of the Organization’s facilities. Management has determined that the monthly service charge is sufficient to cover the costs of any future service obligations of the residents. As such, the Organization has not recorded a liability for the present value of the net costs of any future service obligations.

Advertising: Advertising costs are charged to operations when incurred. Advertising expense was approximately $311,000 for the year ended December 31, 2017.

Retirement plan: The Organization sponsors a defined contribution retirement plan covering all full time employees age 21 and older with at least one year of employment with the Organization. The Organization matches each participant's contribution up to a maximum percentage of annual compensation. Retirement plan expense was approximately $29,000 for the year ended December 31, 2017.

Subsequent events: The Organization has evaluated subsequent events for potential recognition and/or disclosure through June 29, 2018, the date the financial statements were available to be issued.

Note 2. Resident Accounts Receivable

The Organization provides services without collateral to its facility residents, many of whom are local residents and who are insured under third-party payor agreements. The mix of receivables from residents and third-party payors at December 31, 2017 is as follows:

Medicare	$ 330,350
Medicaid	137,389
Insurance	303,760
Private and other	722,327
	1,493,826
Less: allowance for uncollectable accounts	(239,604)
Resident accounts receivable, net	$ 1,254,222

Bad debt expense for the year ended December 31, 2017 was $185,908.

Note 3. Investments and Assets Limited as to Use

The composition of investments as of December 31, 2017 is set forth in the following table:

Cash and cash equivalents	$ 51,654
Mutual funds	992,659
	1,044,313
Less: current portion	(41,579)
Total investments, less current portion	$ 1,002,734

Internally designated cash and cash equivalents that are limited as to use totaled $41,579 as of December 31, 2017.

Investment income is comprised of the following for the year ended December 31, 2017:

Realized gain	$ 1,882
Unrealized loss	(315)
Interest and dividends	3,936
Investment income	$ 5,503

Note 4. Property and Equipment

Property and equipment consists of the following at December 31, 2017:

Land	$ 804,971
Land improvements	185,707
Buildings and improvements	31,575,713
Construction in progress	103,667
Furniture, fixtures and equipment	2,804,544
Vehicles	110,592
Total	35,585,194
Less: accumulated depreciation	(17,576,688)
Property and equipment, net	$ 18,008,506

Depreciation expense on property and equipment totaled $1,472,578 in 2017.

Note 5. Long-Term Debt

The following is a summary of long-term debt at December 31, 2017:

City of Graymoor-Devondale, Kentucky, Health Care Facilities Revenue Bond, Series 2001, due in annual installments through April 2018, with a fixed interest rate of 2.85%	$ 1,562,841
Note payable, no interest, varying payments due monthly May 2015 through April 2019; collateralized by certain building improvements and equipment	32,653
	1,595,494
Less: current maturities	(1,586,841)
Long-term debt, less current maturities	$ 8,653

Scheduled principal payments of long-term debt for the years ending December 31 are as follows:

2018	$ 1,586,841
2019	8,653
Total scheduled principal payments	$ 1,595,494

The Series 2001 Revenue Bonds were issued under a financing arrangement with Stock Yards Bank and Trust Company and the City of Graymoor-Devondale, Kentucky with an original principal amount of $7,000,000. The Organization has pledged its land, building, equipment (excluding Dudley Square property) and any future improvements as collateral for the loan. In March 2018, the Organization made final payment on the Series 2001 Revenue Bonds.

Note 6. Net Assets and Endowments

The Organization's endowment fund includes donor-restricted endowment funds. Donor-restricted funds are presented as permanent and temporarily restricted net assets and consist of amounts restricted for the purpose of charity care, specified capital expenditures and other miscellaneous operational purposes.

Interpretation of relevant law: The Organization has interpreted the Uniform Prudent Management of Institutional Funds Act (the Act) as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment fund absent explicit donor stipulations to the contrary. As a result of this interpretation, the Organization classifies as permanently restricted net assets (1) the original value of gifts donated to the permanent endowment, (2) the original value of subsequent gifts to the permanent endowment, and (3) 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 as permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Organization in a manner consistent with the standard of prudence prescribed in the Act.

At December 31, 2017, the Organization did not hold any endowment assets. The following is the change in endowment net assets for the year ended December 31, 2017:

	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	$ 4,937	$ 42,516	$ 47,453
Transfer to financially interrelated Foundation	(4,937)	(42,516)	(47,453)
Endowment net assets, end of year	$ -	$ -	$ -

Note 7. Functional Expenses

Functional classification of expenses for the year ended December 31, 2017 consisted of the following:

Program services	$ 14,839,979
Management and administrative support	5,073,723
Fundraising	17,882
Total functional expenses	$ 19,931,584

Note 8. Commitments and Contingencies

Litigation: The Organization is subject to asserted and unasserted claims encountered in the normal course of business. The Organization's management and legal counsel assess such contingent liabilities and such assessment inherently involves an exercise of judgment. In assessing loss contingencies related to legal proceedings that are pending against the Organization or unasserted claims that may result in such proceedings, the Organization's legal counsel evaluates the perceived merits of any legal proceedings or unasserted claims as well as the perceived merits of the amount of relief sought or expected to be sought therein. In the opinion of management, disposition of these matters will not have a material effect on the Organization's financial condition or results of operations.

Note 8. Commitments and Contingencies (Continued)

Health plan: The Organization sponsors a partially self-funded health benefit plan for its employee's health care costs. The Organization is responsible for the first $55,000 of claims per employee incurred annually, up to approximately $1,100,000 in the aggregate for all plan participants claims incurred annually. Third party insurance coverage is responsible for amounts in excess per employee and in excess of the aggregate limit. The health insurance expense is based upon actual claims paid, reinsurance premiums, administration fees, and provisions for unpaid and unasserted claims at year-end.

Health insurance expense for the year ended December 31, 2017 was approximately $721,000. A liability for estimated claims outstanding at December 31, 2017 of approximately $117,000 has been recorded for management’s estimate of claims incurred but not yet reported and is included in accrued expenses on the accompanying balance sheet.

Note 9. Fair Value Measurements

For amounts reported at fair value, the Organization adheres to the GAAP framework for measuring fair value which establishes a fair value hierarchy consisting of three levels of inputs that may be used to measure fair value as follows:

Level 1 - Inputs that utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that the Organization 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.

In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety.

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the valuation methodologies used at December 31, 2017.

Mutual funds: Valued at the closing price reported on the active market on which the individual securities are traded.

The method described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Organization believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measured at the reporting date.

Note 9. Fair Value Measurements (Continued)

The following table presents the balances of investments measured at fair value on a recurring basis as of December 31, 2017:

	Level 1	Level 2	Level 3	Total
Assets:				
Investments:				
Mutual funds	$ 992,659	$ -	$ -	$ 992,659
Cash and cash equivalents				51,654
Total investments				1,044,313
Other assets:				
Interest in net assets of financially interrelated Foundation	-	-	8,323,718	8,323,718
Total assets at fair value	$ 992,659	$ -	$ 8,323,718	$ 9,368,031

Changes in Level 3 assets measured at fair value on a recurring basis for the year ended December 31:

Balance, January 1, 2017	$ 7,054,030
Contributions	301,582
Withdrawals	(408,836)
Net unrealized gains	783,298
Net realized gains	522,943
Interest income, net of fees	70,701
Balance, December 31, 2017	$ 8,323,718

Note 10. Affiliation Agreement and Interest in Financially Interrelated Foundation

Effective October 1, 2016, the Organization entered into the Affiliation Agreement (the Affiliation) with Episcopal Retirement Services (ERS). Concurrently with the Affiliation with ERS, the Organization revised its legal name to be The Episcopal Church Home, Inc. and established a new legal entity, The Episcopal Church Home Foundation, Inc. (the Foundation). The Foundation is governed by an independent Board of Directors and is organized to solely support the Organization. In connection with the Affiliation, certain investments and beneficial interests in assets have been transferred from the Organization to the Foundation.

The purpose of the Affiliation with ERS is to further the charitable missions of both ERS and the Organization through various shared affiliation benefits and goals. The Organization amended and restated its articles and bylaws and established a nonprofit corporate membership structure with ERS obtaining 80% interest and the Foundation obtaining 20% interest in the Organization. A new Board of Directors of the Organization is comprised of 9 voting members and 1 non-voting member with ERS appointing 5 of the 9 voting member positions.

The Organization recognizes its interest, and any changes in its interest, in the net assets of the Foundation as a financially interrelated entity. At December 31, 2017, the Organization's interest in the net assets of the Foundation are classified as $2,596,416 of permanently restricted net assets and $5,727,302 of temporarily restricted net assets on the accompanying statement of changes of net assets.

Note 10. Affiliation Agreement and Interest in Financially Interrelated Foundation (Continued)

ERS provides the Organization with management services under the terms of the Affiliation. Annual management fees to be paid to ERS were established at amounts ranging from $1,582,000 to $1,692,000 annually through June 30, 2019. Fees paid to ERS under the affiliation agreement totaled $1,582,000 for the year ended December 31, 2017. At December 31, 2017, $88,831 was owed to ERS and is included in “Accounts payable” on the accompanying balance sheet.

The Foundation has agreed to make certain specified contributions to Organization in addition to operational support contributions as approved by the Foundation Board annually. There were operational support contributions of $273,256 for the year ended December 31, 2017. For the year ended December 31, 2017, the Foundation provided $135,000 in required annual development capacity grants to the Organization. The Foundation is required to provide an additional $135,000 in development capacity grants to the Organization on September 1, 2018.

The Affiliation agreement is scheduled to terminate on October 31, 2021. The termination will have no impact on the Organization’s governance and ERS will continue to maintain its 80% interest in the Organization. ERS and the Foundation may unwind the Affiliation by providing written notice between July 1, 2018 and October 31, 2018. The Foundation’s ability to unwind can be made unilaterally by its Board of Directors based on their evaluation of achievement of shared affiliation goals. If the unwind provision is exercised by the Foundation, all legal relationships between ERS and the Organization will terminate, ERS will cease managing the Organization and will have its rights to participate in the Board revoked, and its 80% member interest will transfer to the Foundation.

The following summarizes the financial position of the financially interrelated Foundation at December 31, 2017:

Assets	
Cash	$ 65,000
Investments	5,516,400
Beneficial interests	2,553,900
Investment in the Organization	300,000
	8,435,300
Liabilities	
Net payable to the Organization	111,582
Net assets	$ 8,323,718
Net assets of financially interrelated Foundation at December 31, 2016	$ 7,054,030
Change in net assets of financially interrelated Foundation for the year ended December 31, 2017	$ 1,269,688

Note 11. Recent Accounting Pronouncements

Revenue recognition: In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. The updated standard will replace most existing revenue recognition guidance in GAAP when it becomes effective and permits the use of either a full retrospective or retrospective with cumulative effect transition method. In August 2015, the FASB issued ASU 2015-14, which defers the effective date of ASU 2014-09 one year, making it effective for annual reporting periods beginning after December 15, 2018. The Organization is currently assessing what impact this new standard may have on its financial statements and is determining the transition method that will be used.

Not-for-profit entities: In August 2016, the FASB issued ASU 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements for Not-for-Profit Entities.* This accounting standard is intended to make improvements to the information provided in the financial statements and accompanying notes of not-for-profit entities. The standard sets forth improvements to net asset classification requirements and the information presented about a not-for-profit entity's liquidity, financial performance and cash flows. ASU 2016-14 will be effective for its fiscal years beginning after December 15, 2017 with early adoption permitted. The Organization is currently evaluating the impact of the pending adoption of the new standard on its financial statements.

Restricted cash: In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash*, which provides guidance on the presentation of restricted cash or restricted cash equivalents in the statement of cash flows. This ASU is effective for period beginning after December 15, 2018 with early adoption permitted. The Company is currently evaluating the impact of the adoption of this ASU on the financial statements.

Note 12. Subsequent Events

On April 1, 2018, the Organization executed a promissory note to borrow up to $4,000,000 from an affiliated entity. The promissory note requires quarterly payments of interest only and bears interest at a rate of 3% through April 1, 2020. After that date, and through the maturity date of April 1, 2043, the promissory note bears interest at a rate of 4% and requires quarterly payments of principal and interest, which are to be determined once borrowings are made in full. As of the date the financial statements were available to be issued, $1,000,000 has been borrowed.

In February 2018, the Organization experienced a flood, which caused damage to certain property and equipment and resulted in lost revenue. A claim has been filed with the Organization's insurance company to recuperate these losses. Management believes the losses incurred as a result of the flood will be substantially covered by proceeds from the insurance claim.