

Alexander Youth Network and Subsidiaries

Consolidated Financial Report
September 30, 2016

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RSM US LLP

Independent Auditor's Report

To the Board of Directors
Alexander Youth Network and Subsidiaries
Charlotte, North Carolina

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Alexander Youth Network and Subsidiaries (AYN), which comprise the consolidated statements of financial position as of September 30, 2016 and 2015, and the related consolidated statements of activities, cash flows and functional expenses for the years then ended, and the related notes to the consolidated financial statements (collectively, 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 audits. We conducted our audits 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 Alexander Youth Network and Subsidiaries as of September 30, 2016 and 2015, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matter

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The consolidating information is presented for purposes of additional analysis rather than to present the financial position, results of operations and cash flows of the individual organizations and is not a required part of the 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 financial statements. The consolidating information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

RSM US LLP

Raleigh, North Carolina
December 21, 2016

Alexander Youth Network and Subsidiaries

Consolidated Statements of Financial Position
September 30, 2016 and 2015

	2016	2015
Assets		
Cash	\$ 3,294,290	\$ 1,216,938
Accounts receivable, net	1,470,545	1,313,729
Contributions receivable, net	1,779,087	1,557,886
Prepaid expenses	256,035	251,623
Investments	7,556,943	7,927,317
Beneficial interest in perpetual trusts	1,352,960	1,348,875
Property and equipment, net	2,190,698	2,348,015
Other assets	91,980	91,980
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Total assets	\$ 17,992,538	\$ 16,056,363
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Liabilities and Net Assets		
Liabilities:		
Accounts payable	\$ 468,506	\$ 471,593
Accrued expenses	997,432	908,053
Note payable	-	10,466
Capital lease obligations	334,404	183,157
Total liabilities	1,800,342	1,573,269
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Commitments and contingencies (Notes 14 and 15)		
Net assets:		
Unrestricted	12,794,707	11,417,973
Temporarily restricted	2,044,529	1,716,246
Permanently restricted	1,352,960	1,348,875
Total net assets	16,192,196	14,483,094
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Total liabilities and net assets	\$ 17,992,538	\$ 16,056,363
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See notes to consolidated financial statements.

Alexander Youth Network and Subsidiaries

Consolidated Statements of Activities
Years Ended September 30, 2016 and 2015

	2016			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
Revenues, gains, losses and other support:				
Net revenue from Care of Children	\$ 22,269,230	\$ -	\$ -	\$ 22,269,230
Government grants	1,655,670	-	-	1,655,670
Private contributions	1,061,340	1,447,128	-	2,508,468
Investment income (loss)	507,666	-	-	507,666
Change in value of beneficial interest in perpetual trusts	-	-	4,085	4,085
Other income	135,815	-	-	135,815
	25,629,721	1,447,128	4,085	27,080,934
Net assets released from restrictions	1,118,845	(1,118,845)	-	-
Total revenues, gains, losses and other support	26,748,566	328,283	4,085	27,080,934
Expenses:				
Program services:				
The Relatives	1,398,664	-	-	1,398,664
Alexander Youth Network	20,528,480	-	-	20,528,480
Total program services	21,927,144	-	-	21,927,144
Supporting services:				
General and administrative	2,449,507	-	-	2,449,507
Advancement	995,181	-	-	995,181
Total supporting services	3,444,688	-	-	3,444,688
Total expenses	25,371,832	-	-	25,371,832
Change in net assets	1,376,734	328,283	4,085	1,709,102
Net assets:				
Beginning of year	11,417,973	1,716,246	1,348,875	14,483,094
End of year	\$ 12,794,707	\$ 2,044,529	\$ 1,352,960	\$ 16,192,196

See notes to consolidated financial statements.

2015

Unrestricted	Temporarily Restricted	Permanently Restricted	Total
\$ 21,832,483	\$ -	\$ -	21,832,483
1,245,987	-	-	1,245,987
1,380,257	1,132,357	-	2,512,614
(209,957)	-	-	(209,957)
-	-	(170,120)	(170,120)
164,080	-	-	164,080
24,412,850	1,132,357	(170,120)	25,375,087
1,126,797	(1,126,797)	-	-
25,539,647	5,560	(170,120)	25,375,087
1,383,697	-	-	1,383,697
21,055,612	-	-	21,055,612
22,439,309	-	-	22,439,309
2,489,006	-	-	2,489,006
1,047,455	-	-	1,047,455
3,536,461	-	-	3,536,461
25,975,770	-	-	25,975,770
(436,123)	5,560	(170,120)	(600,683)
11,854,096	1,710,686	1,518,995	15,083,777
\$ 11,417,973	\$ 1,716,246	\$ 1,348,875	\$ 14,483,094

Alexander Youth Network and Subsidiaries

**Consolidated Statements of Cash Flows
Years Ended September 30, 2016 and 2015**

	2016	2015
Cash flows from operating activities:		
Change in net assets	\$ 1,709,102	\$ (600,683)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	536,767	713,830
Loss on receivables and pledges	311,634	454,543
Investment (gains) losses	(129,789)	766,931
Gain on disposal of property and equipment	(80,157)	-
Change in value of beneficial interests in perpetual trusts	(4,085)	170,120
Changes in assets and liabilities:		
Accounts receivable	(307,639)	(274,855)
Contributions receivable	(382,012)	(258,798)
Prepaid expenses and other assets	(4,412)	(8,590)
Accounts payable	(3,087)	192,944
Accrued expenses	89,379	(472,280)
Net cash provided by operating activities	1,735,701	683,162
Cash flows from investing activities:		
Proceeds from sales of investments	879,062	377,646
Purchases of investments	(378,899)	(1,124,663)
Proceeds from disposal of property and equipment	241,453	-
Purchases of property and equipment	(319,660)	(378,960)
Net cash provided by (used in) investing activities	421,956	(1,125,977)
Cash flows from financing activities:		
Principal payments on note payable	(10,466)	(20,331)
Payments on capital lease obligations	(69,839)	(74,427)
Net cash used in financing activities	(80,305)	(94,758)
Net increase (decrease) in cash	2,077,352	(537,573)
Cash:		
Beginning of year	1,216,938	1,754,511
End of year	\$ 3,294,290	\$ 1,216,938

(Continued)

Alexander Youth Network and Subsidiaries

Consolidated Statements of Cash Flows (Continued)
Years Ended September 30, 2016 and 2015

	2016	2015
Supplemental disclosure of cash flow information:		
Cash payments for interest	<u><u>\$ 13,229</u></u>	<u><u>\$ 21,702</u></u>
Supplemental schedule of noncash investing and financing activities:		
Equipment disposed of through termination of capital leases	<u><u>\$ 126,046</u></u>	<u><u>\$ -</u></u>
Equipment acquired through capital leases	<u><u>\$ 347,132</u></u>	<u><u>\$ 36,698</u></u>

See notes to consolidated financial statements.

Alexander Youth Network and Subsidiaries

**Consolidated Statement of Functional Expenses
Year Ended September 30, 2016**

	Program Services		
	The Relatives	Alexander Youth Network	Subtotal
Personnel costs:			
Salaries	\$ 841,270	\$ 11,347,726	\$ 12,188,996
Payroll taxes and employee benefits	180,570	2,656,321	2,836,891
Total personnel costs	1,021,840	14,004,047	15,025,887
Postage	175	3,437	3,612
Foster care board payments	150	2,616,104	2,616,254
Recreation costs	415	14,030	14,445
Record checks	-	2,560	2,560
Telephone and cable	39,137	318,936	358,073
Insurance, general	24,235	-	24,235
Travel and meals	12,230	391,656	403,886
Legal and accounting	-	-	-
Other professional fees	36,979	718,275	755,254
Food	11,129	277,647	288,776
Utilities	22,651	172,791	195,442
Repairs and maintenance	65,596	575,256	640,852
Supplies and small equipment	34,134	321,383	355,517
Printing	1,970	5,829	7,799
Staff development	3,119	59,175	62,294
Dues and subscriptions	4,454	19,692	24,146
Rent	70,546	493,451	563,997
Advertisement and marketing	1,354	1,083	2,437
Interest	-	-	-
Miscellaneous	11,562	107,097	118,659
Total expenses before depreciation	1,361,676	20,102,449	21,464,125
Depreciation	36,988	426,031	463,019
Total expenses	\$ 1,398,664	\$ 20,528,480	\$ 21,927,144

See notes to consolidated financial statements.

<u>Supporting Services</u>		
<u>General and Administrative</u>	<u>Advancement</u>	<u>Total Expenses</u>
\$ 1,370,125	\$ 566,251	\$ 14,125,372
318,098	138,029	3,293,018
<u>1,688,223</u>	<u>704,280</u>	<u>17,418,390</u>
18,742	5,766	28,120
-	-	2,616,254
73	86	14,604
27,092	919	30,571
18,691	9,584	386,348
133,701	3,633	161,569
23,353	6,726	433,965
94,621	2,696	97,317
123,828	81,183	960,265
12,605	2,551	303,932
17,587	8,022	221,051
30,571	48,699	720,122
23,009	4,493	383,019
10,969	16,818	35,586
9,651	30,561	102,506
29,460	3,357	56,963
23,880	16,569	604,446
64,536	7,057	74,030
12,880	350	13,230
34,460	19,658	172,777
<u>2,397,932</u>	<u>973,008</u>	<u>24,835,065</u>
<u>51,575</u>	<u>22,173</u>	<u>536,767</u>
<u>\$ 2,449,507</u>	<u>\$ 995,181</u>	<u>\$ 25,371,832</u>

Alexander Youth Network and Subsidiaries

**Consolidated Statement of Functional Expenses
Year Ended September 30, 2015**

	Program Services		
	The Relatives	Alexander Youth Network	Sub-Total
Personnel costs:			
Salaries	\$ 795,811	\$ 11,147,774	\$ 11,943,585
Payroll taxes and employee benefits	167,382	2,621,710	2,789,092
Total personnel costs	963,193	13,769,484	14,732,677
Postage	366	1,593	1,959
Foster care board payments	400	3,107,475	3,107,875
Recreation costs	1,053	22,440	23,493
Record checks	-	8,299	8,299
Telephone and cable	50,346	342,356	392,702
Insurance, general	24,068	17,763	41,831
Travel and meals	12,776	349,542	362,318
Legal and accounting	5,866	-	5,866
Other professional fees	31,670	722,552	754,222
Food	14,784	239,549	254,333
Utilities	24,251	168,597	192,848
Repairs and maintenance	86,400	652,753	739,153
Supplies and small equipment	37,437	267,380	304,817
Printing	5,598	8,153	13,751
Staff development	3,152	69,485	72,637
Dues and subscriptions	3,216	16,707	19,923
Rent	80,588	467,306	547,894
Advertisement and marketing	3,233	17,551	20,784
Interest	-	-	-
Miscellaneous	4,176	241,226	245,402
Total expenses before depreciation	1,352,573	20,490,211	21,842,784
Depreciation	31,124	565,401	596,525
Total expenses	\$ 1,383,697	\$ 21,055,612	\$ 22,439,309

See notes to consolidated financial statements.

Supporting Services		
General and Administrative	Advancement	Total Expenses
\$ 1,266,422	\$ 560,021	\$ 13,770,028
298,120	136,805	3,224,017
1,564,542	696,826	16,994,045
20,918	7,987	30,864
-	-	3,107,875
2,422	4,917	30,832
18,537	739	27,575
53,861	12,535	459,098
115,355	4,255	161,441
16,029	9,096	387,443
89,025	2,570	97,461
165,883	97,955	1,018,060
21,866	6,683	282,882
24,909	7,618	225,375
42,357	46,679	828,189
24,768	12,363	341,948
7,414	28,531	49,696
13,015	25,868	111,520
30,445	3,267	53,635
37,847	9,542	595,283
117,152	33,019	170,955
20,955	747	21,702
29,062	27,014	301,478
2,416,362	1,038,211	25,297,357
72,644	9,244	678,413
<u>\$ 2,489,006</u>	<u>\$ 1,047,455</u>	<u>\$ 25,975,770</u>

Alexander Youth Network and Subsidiaries

Notes to Consolidated Financial Statements

Note 1. Nature of Activities and Significant Accounting Policies

Nature of activities: Alexander Youth Network and Subsidiaries (AYN) provides a comprehensive array of services developed to treat children with, or at risk for, serious emotional disturbance. AYN's services include day treatment, outpatient therapy, psychiatric residential treatment, foster care, transitional living, community-based services and a shelter for children in crisis. AYN provides these services from its Charlotte, North Carolina campus and other facilities located throughout the state of North Carolina.

The Charlotte campus is located on 60 acres of land, which is held in trust for the benefit of AYN.

A summary of AYN's significant accounting policies follows:

Principles of consolidation: The consolidated financial statements include the accounts of Alexander Youth Network and its wholly owned subsidiaries, Alexander Youth Network of Lenoir, The Relatives, Inc., and Youth Opportunities (through 2015) and Alexander Children's Foundation. All significant intercompany accounts and transactions have been eliminated in consolidation. In February 2016, Youth Opportunities was merged into AYN and Youth Opportunities ceased operations under its separate legal entity. The merger of assets, liabilities, revenues and expenses were made effective as of October 1, 2015, and had no effect on the consolidated financial statements since Youth Opportunities was previously a wholly owned subsidiary of AYN. 2015 Youth Opportunities balances on the statements of activities and functional expenses have been combined with AYN balances to enhance the comparability of these statements.

During fiscal 2015, the AYN Board of Directors approved the formation of the Alexander Children's Foundation (Foundation) as a tax-exempt entity to support the mission of AYN. The Foundation had no activity in fiscal 2016. The Board of Directors plans to transfer a significant portion of AYN's board-designated endowment to the newly formed Foundation during fiscal 2017. In addition, fundraising activities carried out by AYN will primarily be performed through the Foundation.

Basis of presentation: Net assets and revenues, expenses, gains and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of AYN and changes therein are classified and reported as follows:

Unrestricted net assets: Net assets that are not subject to donor-imposed stipulations. The Board may designate unrestricted net assets for working capital at its discretion.

Temporarily restricted net assets: Net assets subject to donor-imposed stipulations that may or will be met either by actions of AYN and/or the passage of time.

Permanently restricted net assets: Net assets subject to donor-imposed stipulations that they be maintained permanently by AYN. Generally, the donors of these assets permit AYN to use all or part of the income earned on related investments for general or specific purposes.

Contributions and other assets are recognized as restricted support if they are pledged or received with donor stipulations that limit the use of the donation. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statement of activities as net assets released from donor restrictions. Donor-restricted contributions whose restrictions are met in the same reporting period are reported as unrestricted support.

Alexander Youth Network and Subsidiaries

Notes to Consolidated Financial Statements

Note 1. Nature of Activities and Significant Accounting Policies (Continued)

Use of estimates: The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash: AYN's policy is to consider all demand deposits and money market funds as cash. At various times throughout the year, AYN may have cash balances in financial institutions which exceed the amounts which are federally insured. Management believes that such deposits pose no significant credit risk.

Accounts receivable: Accounts receivable are recognized as treatment services are provided and invoiced and are considered past due or delinquent when payment is not received within the credit terms provided by the contractual arrangements. AYN estimates its allowance for doubtful accounts based on collection history and knowledge and dialogue with customers concerning delinquent accounts. Accounts receivable at September 30, 2016 and 2015, is presented net of estimated allowance for doubtful accounts of \$95,560 and \$65,296, respectively. Delinquent accounts receivable are written off when AYN has exhausted all means of collection. Recoveries of receivables previously written off are recorded when recovered.

Contributions receivable: Unconditional promises to give that are expected to be collected within one year are recorded at their net realizable value. Unconditional promises to give that are expected to be collected in future years are recorded at the present value of estimated future cash flows. The discounts on contributions are computed using a rate commensurate with the risk of the contributions receivable in accordance with fair value accounting standards. Amortization of the discount is included in contribution revenue. Conditional promises to give are not included as support until such time as the conditions are substantially met. AYN estimates an allowance for uncollectible contributions based on prior collection and write-off history and its knowledge of and dialogue with donors.

Investments: Investments are presented in the consolidated financial statements at fair value determined in accordance with Topic 820, Fair Value Measurement, of the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC). GAAP defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

FASB ASC Topic 820 permits reporting entities, as a practical expedient, to estimate the fair value of their investments in certain entities that calculate net asset value (NAV) per share (or its equivalent, such as member units or an ownership interest in partners' capital to which a proportionate share of net assets is attributed) by using NAV if the NAV per share of the investment (or its equivalent) is calculated in a manner consistent with the measurement principles of FASB ASC Topic 946, Financial Services—Investment Companies, as of the reporting entity's measurement date.

AYN elects to use NAV as a practical expedient to estimate the fair value of its multi-asset fund. The investee fund managers calculate NAV using fair value estimates of the underlying securities and other financial instruments. The estimated fair values of these underlying investments, which may include private placements and other securities for which prices are not readily available, may not reflect amounts that could be realized upon immediate sale, nor amounts that ultimately may be realized. Accordingly, the estimated fair values may differ significantly from the values that would have been used had a ready market existed for these investments. The fair value of AYN's multi-asset fund generally represents the amount AYN would expect to receive if it were to liquidate its investment, excluding any redemption charges that may apply.

Alexander Youth Network and Subsidiaries

Notes to Consolidated Financial Statements

Note 1. Nature of Activities and Significant Accounting Policies (Continued)

Determining whether an investee fund manager has calculated NAV in a manner consistent with FASB ASC Topic 946 requires AYN to independently evaluate the fair value measurement process utilized to calculate the NAV. Such an evaluation is a matter of professional judgment and includes determining that an investee fund manager has an effective process and related internal controls in place to estimate the fair value of its investments that are included in the calculation of NAV. AYN's evaluation of the process used by investee fund managers includes initial due diligence, ongoing due diligence and financial reporting controls.

AYN's investments include various types of investment securities, which are exposed to various risks, such as interest rate, market and credit risks. Due to the level of risk associated with certain investment securities and the level of uncertainty related to changes in the value of investment securities, it is possible that changes in risks in the near term could materially affect amounts reported in the consolidated financial statements.

Beneficial interest in perpetual trusts: Annual distributions from the various trusts are reported as investment income that increases unrestricted net assets. In conjunction with preparing the year-end consolidated financial statements, AYN re-measures its beneficial interest at fair value, using the same valuation technique that was used to measure the asset initially (see Note 5). Any adjustments are recognized as permanently restricted change in value of beneficial interest in perpetual trusts.

Property and equipment: Property and equipment are stated at cost less accumulated depreciation. Donated property and equipment is initially recorded at fair value at the date of donation. Depreciation on property and equipment is computed on a straight-line basis over the lesser of the estimated useful lives of the assets or the lease term. The cost of maintenance and repairs, which do not improve or extend the life of the respective assets, are expensed when incurred. Depreciable lives are as follows:

Land improvements	5-40 years
Buildings and improvements	5-40 years
Equipment, furniture and fixtures	3-15 years
Vehicles	3-5 years

Donor contributions that are restricted to acquire property and equipment are recorded as temporarily restricted until the property and equipment is acquired. Once acquired, all property and equipment is recorded as unrestricted net assets.

Income taxes: AYN is exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code and the applicable North Carolina Statute. Therefore, no provision for federal or state income taxes has been made in the consolidated financial statements.

Management evaluated AYN's tax positions and concluded that AYN had taken no uncertain tax positions that require adjustment to the consolidated financial statements to comply with the provision of the Income Taxes Topic of the FASB ASC.

Alexander Youth Network and Subsidiaries

Notes to Consolidated Financial Statements

Note 1. Nature of Activities and Significant Accounting Policies (Continued)

Net revenue from Care of Children: The Organization recognizes revenue, net of any discounts or contractual allowances, as the services are provided in accordance with contractual arrangements.

Contribution revenue: Contributions, including unconditional promises to give, are recognized in the period received. Contributions of assets other than cash are recorded at estimated fair value. Contributions of property and equipment without donor-imposed restrictions concerning the use of such long-lived assets are reported as revenues in the unrestricted net asset class.

Government grants: AYN receives grants from local and state government agencies to operate certain program services. AYN recognizes revenue under these arrangements as the services are performed.

Functional allocation of expenses: AYN allocates certain of its expenses to program and supporting services based on management's estimates of the respective service's personnel requirements, supplies and materials usage, and space and equipment utilization.

Reclassifications: Certain reclassifications were made to the prior year amounts to conform to the current year's presentation with no effect on net assets or change in net assets.

Subsequent events: AYN has evaluated its subsequent events (events occurring after September 30, 2015) through December 21, 2016, which represents the date the consolidated financial statements were available to be issued.

Recent accounting pronouncements: In August 2016, the FASB issued Accounting Standards Update (ASU) 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. The amendments in this Update make several improvements to reporting requirements including changes to net asset classification and requiring additional disclosures related to various not-for-profit issues. The amendments in this Update are effective for annual financial statements issued for fiscal years beginning after December 15, 2017 and should be applied retrospectively upon adoption, with certain limited exceptions. Early adoption is permitted. AYN is currently evaluating the effect that the updated standard will have on the consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. The amendments in the Update increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the statement of financial position and disclosing key information about leasing arrangements. The amendments in the Update are effective for annual financial statements issued for fiscal years beginning after December 15, 2019. Early application is permitted. AYN is currently evaluating the effect that the updated standard will have on the consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers*. The updated standard requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. 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. Early adoption is permitted with certain restrictions. The updated standard becomes effective for annual reporting periods beginning after December 15, 2018. AYN has not selected a transition method and is currently evaluating the effect that the updated standard will have on the consolidated financial statements.

Alexander Youth Network and Subsidiaries

Notes to Consolidated Financial Statements

Note 2. Contributions Receivable

As of September 30, 2016 and 2015, contributions receivable consist of the following:

	2016	2015
Amounts due:		
In one year or less	\$ 1,136,166	\$ 787,996
Between one year and five years	966,016	1,049,279
	<u>2,102,182</u>	<u>1,837,275</u>
Less unamortized discount	(13,793)	(14,381)
Less allowance for uncollectible contributions	(309,302)	(265,008)
	<u>\$ 1,779,087</u>	<u>\$ 1,557,886</u>

The discount rate used for contributions receivable received in fiscal 2016 was 0.70%. The discount rate for contributions receivable received in years prior to fiscal 2016 ranged from 0.70% to 3.76%.

Note 3. Beneficial Interest in Perpetual Trusts

AYN has been named as a beneficiary in five trust agreements in which AYN will receive investment income payments in perpetuity. At the time, AYN was notified of each trust's existence, a receivable and contribution revenue were recorded at the present value of the estimated future cash receipts. AYN remeasures its beneficial interests at fair value on an annual basis. Discount rates of 4.32% and 4.87% were used to calculate the present value of the estimated future cash receipts as of September 30, 2016 and 2015, respectively. Distributions from the trusts are unrestricted and are reflected as a component of investment income (loss) (see Note 5).

Note 4. Investments

The composition of investments at September 30, 2016 and 2015, is as follows:

	2016	2015
TIFF Multi-Asset Fund	\$ 7,556,943	\$ 7,428,804
Fixed Income Securities and Equities	-	498,513
	<u>\$ 7,556,943</u>	<u>\$ 7,927,317</u>

Investment income (loss) for the years ended September 30, 2016 and 2015, is as follows:

	2016	2015
Investment income, net of fees	\$ 321,978	\$ 505,193
Net appreciation (depreciation) in fair value of investments	129,789	(766,931)
Income distributions from perpetual trusts (Note 5)	55,899	51,781
	<u>\$ 507,666</u>	<u>\$ (209,957)</u>

Alexander Youth Network and Subsidiaries

Notes to Consolidated Financial Statements

Note 5. Fair Value of Financial Instruments

FASB ASC 820, Fair Value Measurement, establishes a framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under FASB ASC 820 are described below:

Level 1: Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets at the measurement date.

Level 2: Inputs to the valuation methodology include: quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in inactive markets; inputs other than quoted prices that are observable for the asset or liability; and inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3: Unobservable inputs that reflect management's best estimate of what market participants would use in pricing the asset or liability at the measurement date.

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

In determining fair value, AYN uses valuation approaches within the FASB ASC 820 fair value measurement framework and utilizes the end of reporting period for determining when transfers between levels are recognized. The following is a description of the valuation methodologies used for instruments measured at fair value and their classification within the hierarchy.

Fixed income securities: Investments in debt securities include corporate bonds and funds and government and government agency obligation bonds and funds. Certain bond funds are listed on national markets or exchanges and are valued at the last sales price, or if there is no sale and the market is considered active, at the mean of the last bid and asked prices on such exchange. Such securities are classified within Level 1 of the valuation hierarchy. All other fixed income investments are valued using market observable data, such as reported sales of similar securities, broker quotes, yields, bids, offers and reference data, and classified within Level 2 of the hierarchy.

Equity securities: Equity securities listed on national markets or exchanges are valued at the last sales price, or if there is no sale and the market is considered active, at the mean of the last bid and asked prices on such exchange. Such securities are classified within Level 1 of the valuation hierarchy.

Beneficial interest in perpetual trusts: Fair value is based on estimated future cash flows, determined from an average of actual cash flows from the previous four years, discounted at a rate of 4.32% and 4.87% as of September 30, 2016 and 2015, respectively.

Alexander Youth Network and Subsidiaries

Notes to Consolidated Financial Statements

Note 5. Fair Value of Financial Instruments (Continued)

The following tables set forth, by level within the fair value hierarchy, AYN's assets measured at fair value subsequent to initial recognition on a recurring basis.

Description	Assets at Fair Value as of September 30, 2016			
	Level 1	Level 2	Level 3	Total
Investments:				
Multi-asset fund (a)				\$ 7,556,943
Beneficial interests in:				
Perpetual trusts	\$ -	\$ -	\$ 1,352,960	1,352,960
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,352,960</u>	<u>\$ 8,909,903</u>

Description	Assets at Fair Value as of September 30, 2015			
	Level 1	Level 2	Level 3	Total
Investments:				
Corporate bonds	\$ -	\$ 178,974	\$ -	\$ 178,974
Government bonds	-	185,007	-	185,007
Government asset backed	-	52,527	-	52,527
Other fixed income	27,423	47,097	-	74,520
Equities	7,485	-	-	7,485
Multi-asset fund (a)				7,428,804
	<u>34,908</u>	<u>463,605</u>	<u>-</u>	<u>7,927,317</u>
Beneficial interests in:				
Perpetual trusts	-	-	1,348,875	1,348,875
	<u>\$ 34,908</u>	<u>\$ 463,605</u>	<u>\$ 1,348,875</u>	<u>\$ 9,276,192</u>

(a) In accordance with FASB ASU 2015-07, certain investments that are measured at fair value using the NAV per share (or its equivalent) practical expedient have not been classified in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the consolidated statements of financial position.

AYN evaluates the significance of transfers between levels based upon the nature of the investment and size of the transfer relative to total net assets. For the years ended September 30, 2016 and 2015, there were no significant transfers in or out of Levels 1, 2 or 3.

Alexander Youth Network and Subsidiaries

Notes to Consolidated Financial Statements

Note 5. Fair Value of Financial Instruments (Continued)

The table below sets forth a summary of changes in the fair value of AYN's Level 3 assets for the years ended September 30, 2016 and 2015.

	Beneficial Interest in Perpetual Trusts
Balance at October 1, 2014	\$ 1,518,995
Investment income	51,781
Distributions	(51,781)
Change in fair value	(170,120)
Balance at September 30, 2015	1,348,875
Investment income	55,899
Distributions	(55,899)
Change in fair value	4,085
Balance at September 30, 2016	<u>\$ 1,352,960</u>

The following table sets forth attributes related to the nature and risk of investment funds whose fair value is estimated using NAV per share (or its equivalent) as of September 30, 2016 and 2015.

Investment	Fair Value		Unfunded Commitment	Redemption Frequency	Redemption Restrictions	Notice Period
	2016	2015				
Multi-asset fund (a)	\$ 7,556,943	\$ 7,428,804	\$ -	Daily	None	Daily

(a) The primary investment objective of the portfolio is to achieve an annualized total return, through appreciation and income, greater than the rate of inflation plus 5% per annum by employing a globally diversified portfolio.

Note 6. Property and Equipment

The composition of property and equipment at September 30, 2016 and 2015, is as follows:

	2016	2015
Land and land improvements	\$ 269,270	\$ 352,784
Buildings and improvements	5,173,302	5,412,974
Equipment, furniture and fixtures	4,963,822	4,729,622
Vehicles	521,327	386,686
	<u>10,927,721</u>	<u>10,882,066</u>
Less accumulated depreciation	8,801,873	8,551,051
	<u>2,125,848</u>	<u>2,331,015</u>
Construction in progress	64,850	17,000
	<u>\$ 2,190,698</u>	<u>\$ 2,348,015</u>

Alexander Youth Network and Subsidiaries

Notes to Consolidated Financial Statements

Note 7. Line of Credit

AYN has a \$4,000,000 line of credit with a local bank, which was renewed in the current period through March 2017. The principal outstanding is due on demand with interest at the bank's prime rate with a minimum rate of 4%. There were no borrowings on the line of credit for the years ended September 30, 2016 and 2015.

Note 8. Note Payable

AYN had a note payable to a bank that was due in monthly installments including a fixed rate of interest of 3.9%. The note payable was paid off in April 2016. The balance outstanding on the note payable was \$10,466 as of September 30, 2015.

Note 9. Capital Lease Obligations

AYN leases certain office equipment and vehicles under capital lease agreements that are due in monthly installments with interest at rates of 4.0% through 2021. The following is a summary of capital lease obligations at September 30, 2016 and 2015:

	2016	2015
Present value of minimum capital lease payments	\$ 334,404	\$ 183,157
Less current maturities	70,555	56,374
	<u>\$ 263,849</u>	<u>\$ 126,783</u>

The following is a schedule by years of future minimum lease payments of capital leases with the present value of net minimum lease payments at September 30, 2016:

	Amount
Years ending:	
2017	\$ 81,633
2018	81,633
2019	81,633
2020	81,633
2021	36,628
Total minimum lease payments	363,160
Less amount representing interest and executory costs	28,756
Present value of minimum capital lease payments	<u>\$ 334,404</u>

Following is a summary of leased property under capital leases at September 30, 2016 and 2015:

	2016	2015
Copiers	\$ 383,830	\$ 291,325
Vehicles	-	81,615
	383,830	372,940
Less accumulated depreciation	54,498	202,085
	<u>\$ 329,332</u>	<u>\$ 170,855</u>

Alexander Youth Network and Subsidiaries

Notes to Consolidated Financial Statements

Note 10. Temporarily Restricted Net Assets

Temporarily restricted net assets at September 30, 2016 and 2015, are available for the following purposes or periods:

	2016	2015
Time restricted	\$ 1,779,087	\$ 1,557,886
Group home	35,240	35,240
Programs	230,202	123,120
	<u>\$ 2,044,529</u>	<u>\$ 1,716,246</u>

Net assets during the years ended September 30, 2016 and 2015, were released from donor restrictions by incurring expenses satisfying the restricted purposes or by occurrence of other events specified by the donors.

	2016	2015
Time restrictions met:		
Collections on pledges receivable	\$ 1,044,437	\$ 909,180
Purpose restrictions accomplished:		
Program expenditures made	74,408	217,617
	<u>\$ 1,118,845</u>	<u>\$ 1,126,797</u>

Note 11. Permanently Restricted Net Assets

Permanently restricted net assets at September 30, 2016 and 2015, consist of beneficial interests in perpetual trusts that are invested in perpetuity from which AYN receives investment income payments. The investment income earned thereon does not have purpose restrictions and is, therefore, classified as unrestricted investment income (see Note 5).

Note 12. Retirement Plan

Alexander Youth Network and a subsidiary have established salary deferral plans under Section 401(k) of the Internal Revenue Code for the benefit of its employees. The plans allow eligible employees to contribute a portion of their compensation into the plan. The plans also allow for employer contributions through matching or profit sharing as defined by each plan's provisions. For the years ended September 30, 2016 and 2015, AYN recognized \$381,339 and \$232,866, respectively, as employer contributions to the plans.

Alexander Youth Network and Subsidiaries

Notes to Consolidated Financial Statements

Note 13. Board-Designated Endowment

AYN's endowment is established to provide income for use in operations and consists primarily of its investment in a multi-asset fund. Its endowment includes funds designated by the Board of Directors to function as endowments. As required by GAAP, net assets associated with endowment funds, including funds designated by the Board of Directors to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

Return objective and risk parameters: AYN's objective is to earn a respectable, long-term, risk-adjusted total rate of return to support the designated programs. AYN recognizes and accepts that pursuing a respectable rate of return involves risk and potential volatility. The generation of current income will be a secondary consideration. AYN targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints. AYN has established a policy portfolio, or normal asset allocation. While the policy portfolio can be adjusted from time to time, it is designed to serve for long-time horizons based upon long-term expected returns.

Strategies employed for achieving objectives: To satisfy its long-term rate-of-return objectives, AYN relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). AYN targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

Spending policy and how the investment objectives relate to spending policy: AYN will appropriate for expenditure in its annual budget a maximum of 5% of the prior three years' average ending market value of the endowment assets. There may be times when AYN may opt not to take the maximum spending rate, but rather reinvest some of the annual return. This spending rate is based on the long-term assumption of an average annual total return (net of fees) of at least 5% plus inflation.

Changes in board-designated unrestricted net assets for the years ended September 30, 2016 and 2015, are as follows:

	2016	2015
Board-designated endowment, beginning of the year	\$ 7,438,367	\$ 7,462,248
Investment return:		
Investment income, net of fees	320,743	492,903
Net appreciation (depreciation) in fair value of investments	127,523	(762,850)
Total investment return	448,266	(269,947)
Designation of assets as board designated	57,656	612,792
Appropriation of endowment assets for expenditure	(377,783)	(366,726)
Board-designated endowment, end of year	\$ 7,566,506	\$ 7,438,367

Alexander Youth Network and Subsidiaries

Notes to Consolidated Financial Statements

Note 14. Lease Commitments

AYN has entered into various operating lease agreements for office space and equipment that expire over the next three years.

Total rent expense for all cancelable and non-cancelable leases was approximately \$604,000 and \$595,000 for 2016 and 2015, respectively.

Future minimum annual lease payments for all significant non-cancelable operating leases outstanding at September 30, 2016, are as follows:

	<u>Amount</u>
Fiscal years ending September 30:	
2017	\$ 524,042
2018	283,426
2019	53,977
2020	20,782
2021	5,234
	<u>\$ 887,461</u>

Note 15. Contingencies

AYN participates in federal, state and local government grant programs, the expenditures for which are subject to audit from the respective funding agencies and/or the Governmental Accountability Office. Upon examination, expenditures could be disallowed and refunds required. AYN has not been notified that any such audits are forthcoming and is not aware of any expenditures for which such allowances or refunds would be required by funding agencies.

AYN's regulatory environment is undergoing significant changes due to the efforts within the industry to manage cost and provide a uniform management system by combining the management of both State and Medicaid funds at the community level. The majority of AYN's revenue from care of children comes through these regulated channels; therefore, it is possible that continued changes in the regulatory environment could materially affect amounts reported in the consolidated financial statements.

Alexander Youth Network and Subsidiaries

Consolidating Statement of Financial Position September 30, 2016

	Alexander Youth Network*	The Relatives	Eliminations	Total
Assets				
Cash	\$ 3,277,659	\$ 16,631	\$ -	\$ 3,294,290
Accounts receivable, net	1,350,551	119,994	-	1,470,545
Contributions receivable, net	1,235,526	543,561	-	1,779,087
Prepaid expenses	250,134	5,901	-	256,035
Investments	7,024,733	532,210	-	7,556,943
Beneficial interest in perpetual trusts	1,352,960	-	-	1,352,960
Property and equipment, net	1,852,080	338,618	-	2,190,698
Intercompany receivables	-	872,524	(872,524)	-
Other assets	82,417	9,563	-	91,980
Total assets	\$ 16,426,060	\$ 2,439,002	\$ (872,524)	\$ 17,992,538
Liabilities and Net Assets				
Liabilities:				
Accounts payable	\$ 327,123	\$ 141,383	\$ -	\$ 468,506
Accrued expenses	920,711	76,721	-	997,432
Capital lease obligations	334,404	-	-	334,404
Intercompany payables	872,524	-	(872,524)	-
Total liabilities	2,454,762	218,104	(872,524)	1,800,342
Commitments and contingencies				
Total net assets	13,971,298	2,220,898	-	16,192,196
Total liabilities and net assets	\$ 16,426,060	\$ 2,439,002	\$ (872,524)	\$ 17,992,538

* Youth Opportunities (YO) merged into Alexander Youth Network. YO balances are included as of the beginning of the year. See Note 1 for further details.

Alexander Youth Network and Subsidiaries

Consolidating Statement of Activities Year Ended September 30, 2016

	Alexander Youth Network*	The Relatives	Total
Revenues, gains, losses and other support:			
Net revenue from care of children	\$ 22,001,149	\$ 268,081	\$ 22,269,230
Government grants	721,289	934,381	1,655,670
Private contributions	1,625,752	882,716	2,508,468
Investment income	474,109	33,557	507,666
Change in value of beneficial interest in perpetual trusts	4,085	-	4,085
Other income	95,589	40,226	135,815
Total revenues, gains, losses and other support	24,921,973	2,158,961	27,080,934
Expenses:			
Program services	20,528,480	1,398,664	21,927,144
Supporting services:			
General and administrative	2,311,004	138,503	2,449,507
Advancement	710,994	284,187	995,181
Total expenses	23,550,478	1,821,354	25,371,832
Change in net assets	1,371,495	337,607	1,709,102
Net assets:			
Beginning of year	12,599,803	1,883,291	14,483,094
End of year	<u>\$ 13,971,298</u>	<u>\$ 2,220,898</u>	<u>\$ 16,192,196</u>

* Youth Opportunities (YO) merged into Alexander Youth Network. YO balances are included as of the beginning of the year. See Note 1 for further details.