



Children's Health Council, Inc.
Financial Statements
June 30, 2017
(With Comparative Totals for 2016)

Audit Committee and Board of Directors
Children's Health Council, Inc.
Palo Alto, California

Certified
Public
Accountants



Palo Alto
San Francisco
San Jose
St. Helena

INDEPENDENT AUDITORS' REPORT

Report on the Financial Statements

We have audited the accompanying financial statements of Children's Health Council, Inc., which comprise the statement of financial position as of June 30, 2017, and the related statements of activities, functional expenses 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.

Auditors' 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 of 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 auditors' 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 Children's Health Council, Inc. as of June 30, 2017, and the 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.

Report on Summarized Comparative Information

We have previously audited Children's Health Council, Inc.'s June 30, 2016 financial statements, and our report dated November 11, 2016, expressed an unmodified opinion on those audited financial statements. In our opinion, the summarized comparative information presented herein as of and for the year ended June 30, 2016, is consistent, in all material respects, with the audited financial statements from which it has been derived.

A handwritten signature in black ink that reads "Frank, Rimmerman & Co. LLP". The signature is written in a cursive, flowing style.

Palo Alto, California
October 10, 2017

Children's Health Council, Inc.
Statement of Financial Position
June 30, 2017 (with Summarized Comparative Totals for 2016)

	June 30, 2017				June 30, 2016 Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	
ASSETS					
Cash and Cash Equivalents	\$ 1,338,444	\$ 155,000	\$ 654,154	\$ 2,147,598	\$ 3,373,673
Accounts Receivable, net of allowance for doubtful accounts of \$50,000	1,302,051	-	-	1,302,051	1,708,858
Pledges Receivable, net	-	807,031	682,071	1,489,102	1,332,210
Prepaid Expenses and Other Assets	137,877	-	-	137,877	49,463
Investments	3,722,803	6,549,591	20,404,705	30,677,099	25,766,330
Property and Equipment, net	9,658,076	-	-	9,658,076	9,786,861
Total assets	\$ 16,159,251	\$ 7,511,622	\$ 21,740,930	\$ 45,411,803	\$ 42,017,395
LIABILITIES AND NET ASSETS					
Liabilities					
Accounts payable	\$ 142,646	\$ -	\$ -	\$ 142,646	\$ 137,945
Accrued expenses and other liabilities	1,340,525	-	-	1,340,525	1,011,013
Deferred revenue	1,261,123	-	-	1,261,123	1,148,054
Total liabilities	2,744,294	-	-	2,744,294	2,297,012
Commitments and Contingency (Notes 4, 9 and 10)					
Net Assets					
Unrestricted					
Undesignated	6,414,957	-	-	6,414,957	13,863,203
Board designated	7,000,000	-	-	7,000,000	-
Temporarily restricted	-	7,511,622	-	7,511,622	4,727,935
Permanently restricted	-	-	21,740,930	21,740,930	21,129,245
Total net assets	13,414,957	7,511,622	21,740,930	42,667,509	39,720,383
Total liabilities and net assets	\$ 16,159,251	\$ 7,511,622	\$ 21,740,930	\$ 45,411,803	\$ 42,017,395

See Notes to Financial Statements

Children's Health Council, Inc.
Statement of Activities
Year Ended June 30, 2017 (with Summarized Comparative Totals for 2016)

	Year Ended June 30, 2017				Year
	Unrestricted	Temporarily	Permanently	Total	Ended
		Restricted	Restricted		Total
					Total
Public Support					
Donations	\$ 2,621,435	\$ -	\$ 611,685	\$ 3,233,120	\$ 983,160
Special events, net	482,261	-	-	482,261	397,875
Foundation and trust grants	-	638,851	-	638,851	824,500
	<u>3,103,696</u>	<u>638,851</u>	<u>611,685</u>	<u>4,354,232</u>	<u>2,205,535</u>
Revenue					
Patient fees and insurance payments	1,676,813	-	-	1,676,813	1,419,296
School district funding	7,012,497	-	-	7,012,497	6,421,679
Government contracts	2,542,379	-	-	2,542,379	2,864,417
Tuition	1,991,000	-	-	1,991,000	1,667,187
Other income	256,480	-	-	256,480	309,669
	<u>13,479,169</u>	<u>-</u>	<u>-</u>	<u>13,479,169</u>	<u>12,682,248</u>
Net Assets Released from Restrictions	668,000	(668,000)	-	-	-
Total public support and revenue	<u>17,250,865</u>	<u>(29,149)</u>	<u>611,685</u>	<u>17,833,401</u>	<u>14,887,783</u>
Expenses					
Program services:					
Outpatient clinical services	5,474,579	-	-	5,474,579	4,839,462
School services	8,295,231	-	-	8,295,231	7,146,948
	<u>13,769,810</u>	<u>-</u>	<u>-</u>	<u>13,769,810</u>	<u>11,986,410</u>
Supporting services:					
Administration, management and general	2,261,898	-	-	2,261,898	2,415,774
Fundraising	830,056	-	-	830,056	643,191
Marketing	421,485	-	-	421,485	353,269
	<u>3,513,439</u>	<u>-</u>	<u>-</u>	<u>3,513,439</u>	<u>3,412,234</u>
Total expenses	<u>17,283,249</u>	<u>-</u>	<u>-</u>	<u>17,283,249</u>	<u>15,398,644</u>
Increase (decrease) in net assets from operations	(32,384)	(29,149)	611,685	550,152	(510,861)
Investment Income (Loss)					
Interest, dividends and earnings, net	89,791	578,597	-	668,388	490,199
Net realized and unrealized gain (loss)	(57,704)	1,786,290	-	1,728,586	(769,838)
Net investment income (loss)	<u>32,087</u>	<u>2,364,887</u>	<u>-</u>	<u>2,396,974</u>	<u>(279,639)</u>
Change in Net Assets	(297)	2,335,738	611,685	2,947,126	(790,500)
Net Assets, beginning of year	13,415,254	5,175,884	21,129,245	39,720,383	40,510,883
Net Assets, end of year	<u>\$ 13,414,957</u>	<u>\$ 7,511,622</u>	<u>\$ 21,740,930</u>	<u>\$ 42,667,509</u>	<u>\$ 39,720,383</u>

See Notes to Financial Statements

Children's Health Council, Inc.
Statement of Functional Expenses
Year Ended June 30, 2017

	Outpatient Clinical Services	School Services	Total Program Services	Administration, Management and General	Fundraising	Marketing	Total Supporting Services	Total
Salaries, Benefits, Contract Staff and Payroll Taxes	\$ 4,657,933	\$ 6,040,063	\$ 10,697,996	\$ 1,583,362	\$ 553,585	\$ 226,460	\$ 2,363,407	\$ 13,061,403
Operating Expenses	592,861	1,795,890	2,388,751	483,657	269,622	190,120	943,399	3,332,150
Utilities and Maintenance	60,754	122,114	182,868	54,131	2,309	912	57,352	240,220
Insurance	24,184	46,403	70,587	18,197	1,820	1,820	21,837	92,424
Total Expenses before Depreciation	5,335,732	8,004,470	13,340,202	2,139,347	827,336	419,312	3,385,995	16,726,197
Depreciation	138,847	290,761	429,608	122,551	2,720	2,173	127,444	557,052
Total expenses	<u>\$ 5,474,579</u>	<u>\$ 8,295,231</u>	<u>\$ 13,769,810</u>	<u>\$ 2,261,898</u>	<u>\$ 830,056</u>	<u>\$ 421,485</u>	<u>\$ 3,513,439</u>	<u>\$ 17,283,249</u>
Percentage of Total Expenses	<u>32%</u>	<u>48%</u>	<u>80%</u>	<u>13%</u>	<u>5%</u>	<u>2%</u>	<u>20%</u>	<u>100%</u>

See Notes to Financial Statements

Children's Health Council, Inc.
Statement of Functional Expenses
Year Ended June 30, 2016

	Outpatient Clinical Services	School Services	Total Program Services	Administration, Management and General	Fundraising	Marketing	Total Supporting Services	Total
Salaries, Benefits, Contract Staff and Payroll Taxes	\$ 4,253,298	\$ 5,173,512	\$ 9,426,810	\$ 1,848,335	\$ 389,810	\$ 194,300	\$ 2,432,445	\$ 11,859,255
Operating Expenses	372,531	1,542,450	1,914,981	384,753	236,227	154,106	775,086	2,690,067
Utilities and Maintenance	57,033	115,551	172,584	51,252	4,734	864	56,850	229,434
Insurance	30,663	51,707	82,370	20,277	2,028	2,028	24,333	106,703
Total Expenses before Depreciation	4,713,525	6,883,220	11,596,745	2,304,617	632,799	351,298	3,288,714	14,885,459
Depreciation	125,937	263,728	389,665	111,157	10,392	1,971	123,520	513,185
Total expenses	<u>\$ 4,839,462</u>	<u>\$ 7,146,948</u>	<u>\$ 11,986,410</u>	<u>\$ 2,415,774</u>	<u>\$ 643,191</u>	<u>\$ 353,269</u>	<u>\$ 3,412,234</u>	<u>\$ 15,398,644</u>
Percentage of Total Expenses	<u>31%</u>	<u>47%</u>	<u>78%</u>	<u>16%</u>	<u>4%</u>	<u>2%</u>	<u>22%</u>	<u>100%</u>

See Notes to Financial Statements

Children's Health Council, Inc.
Statements of Cash Flows

	Years Ended June 30,	
	2017	2016
Cash Flows from Operating Activities		
Change in net assets	\$ 2,947,126	\$ (790,500)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	557,052	513,185
Change in discount on pledges receivable	(42,116)	(5,908)
Net realized and unrealized (gain) loss on investments	(1,728,586)	769,838
Contributions restricted for endowment	(611,685)	(52,449)
Changes in operating assets and liabilities:		
Accounts receivable	406,807	(679,353)
Pledges receivable	(129,816)	436,474
Prepaid expenses and other assets	(88,414)	(8,245)
Accounts payable and other current liabilities	334,213	(202,053)
Deferred revenue	113,069	180,339
Net cash provided by operating activities	<u>1,757,650</u>	<u>161,328</u>
Cash Flows from Investing Activities		
Proceeds from sale and distribution of investments	9,955,499	8,352,205
Purchase of investments	(13,137,682)	(8,806,810)
Purchase of property and equipment	(428,267)	(260,759)
Net cash used in investing activities	<u>(3,610,450)</u>	<u>(715,364)</u>
Cash Flows from Financing Activities		
Proceeds from pledges receivable restricted for endowment	626,725	210,511
Net cash provided by financing activities	<u>626,725</u>	<u>210,511</u>
Net Decrease in Cash and Cash Equivalents	(1,226,075)	(343,525)
Cash and Cash Equivalents, beginning of year	<u>3,373,673</u>	<u>3,717,198</u>
Cash and Cash Equivalents, end of year	<u>\$ 2,147,598</u>	<u>\$ 3,373,673</u>

See Notes to Financial Statements

Children's Health Council, Inc.

Notes to Financial Statements

1. Organization

Children's Health Council, Inc. (CHC) is a private, not-for-profit, tax-exempt corporation that believes in the promise and potential of every child. CHC's mission is to remove barriers to learning, helping children and teens become resilient, happy and successful at home, school and in life. CHC's quest is to remove social, emotional and learning barriers for children and their families, regardless of language, location or ability to pay. For over 60 years, CHC has helped children, teens and families find the best ways to learn, develop and thrive.

CHC is organized into five distinct service divisions:

The Center at Children's Health Council provides expert interdisciplinary evaluations, individualized treatment and innovative programs to meet every child's unique challenges and needs. CHC works with families and schools to provide individualized treatment solutions for ADHD and inattention, Autism Spectrum Disorder, learning challenges, and anxiety and depression. CHC empowers children, teens and young adults between the ages of 2 and 25 with social, emotional, physical and academic learning challenges to uncover their greatest potential.

The Esther B. Clark School (EBC School), a nonpublic school with a campus located at CHC, provides transformative education in a caring, therapeutic day school setting where children with severe emotional and behavioral issues re-engage in learning and develop the positive behaviors necessary to transition back to a district school. EBC School serves students between the ages of 7 and 16 who have a primary special education eligibility for Emotionally Disturbed or Other Health Impaired and have not been able to derive benefit from their previous school setting. EBC School employs a combination of therapeutic, academic and enrichment opportunities to create an individualized comprehensive plan for each student. When a student is equipped emotionally and educationally to return to local public school, he or she is gradually transitioned to ensure successful reintegration, generally within one to two years.

Sand Hill School is a private school with a campus located at CHC. Sand Hill School works with bright children with dyslexia or other language-based learning differences, attention and social challenges and prepares them to transition back to a traditional classroom. Programs emphasize students' strengths and empower each child to build academic skills and resiliency while developing strong social competencies and a joy for learning. A low student to teacher ratio and coordination with CHC therapists, clinicians, and specialists create a unique and happy environment for grades 1-8.

Children's Health Council, Inc.
Notes to Financial Statements

1. Organization (continued)

The Community Clinic's nurturing specialists help the underserved by providing assessment and treatment services for children up to 18 years, who face a full range of mental health, developmental and behavioral issues. The Community Clinic uses a personalized approach to lift barriers to help each child develop and learn to his or her greatest potential. Services are primarily funded by Santa Clara Medi-Cal funding.

The Parent, Teacher & Continuing Education division offers an array of unique classes from September through May presented by CHC's experts in psychology, education and child development. Classes provide insights and answers on child behavior issues; executive functioning; bullying; signs and tips for ADHD; anxiety and depression; dyslexia and learning differences; autism; and supporting the happiness and success for all children and teens.

2. Significant Accounting Policies

Financial Statement Presentation:

CHC prepares its financial statements on the accrual basis of accounting. CHC segregates its assets and liabilities, operations and cash flows into three categories: unrestricted, temporarily restricted and permanently restricted. Unrestricted assets are those available for use in the general activities of CHC, without restrictions by donors. Temporarily restricted assets are those whose use is restricted by the donor, based on time or purpose. Generally, these funds will be expended for a specified purpose or over a period of time and are not currently available for general use. Permanently restricted assets are endowment assets restricted by the donor in perpetuity and consist of cash equivalents, investments, and pledges receivable.

Unrestricted net assets consist of net assets for which there are no donor-imposed restrictions or such donor-imposed restrictions were temporary and expired during the current or previous periods. These assets are available for use at the discretion of CHC's Board of Directors.

In 2017, CHC's Board of Directors designated \$7,000,000 as a reserve fund, which is reflected as Board Designated Unrestricted Net Assets at June 30, 2017. Of this reserve, \$5,000,000 is designated for operating reserves, and \$2,000,000 is designated for the creek stabilization reserve.

Children's Health Council, Inc.
Notes to Financial Statements

2. Significant Accounting Policies (continued)

Revenue Recognition:

CHC recognizes contributions, including promises to give (pledges), in the period the donor makes a promise to give that is, in substance, unconditional. Contributions restricted by the donor are reported as increases in unrestricted net assets if the restrictions expire in the fiscal year in which the revenue is recognized. All other donor-restricted contributions are reported as increases in temporarily or permanently restricted net assets depending on the nature of the restrictions. When a restriction as to time or use expires, temporarily restricted net assets are reclassified to unrestricted net assets.

Pledges are stated at their net present value based on the expected date of receipt using a discount rate. CHC records an allowance against a pledge receivable when collectability is uncertain.

Patient fees, insurance payments, tuition, school district funding and government contract revenue are recognized in the period in which the services are provided. Amounts received for these services not yet provided are classified as deferred revenue.

Special Events:

Revenues from special events are reported net of direct costs and expenses. Revenues and expenses associated with special events are as follows for the years ended June 30:

	<u>2017</u>	<u>2016</u>
Rocktoberfest	\$ 481,489	\$ 411,013
Rocktoberfest in-kind goods and services	81,425	94,507
Children's Health Council Breakfast	<u>144,346</u>	<u>115,012</u>
Total revenues	707,260	620,532
Rocktoberfest cash expenditures	102,237	84,075
Rocktoberfest in-kind goods and services	81,425	94,507
Children's Health Council Breakfast	<u>41,337</u>	<u>44,075</u>
Total expenses	<u>224,999</u>	<u>222,657</u>
Special events, net	<u>\$ 482,261</u>	<u>\$ 397,875</u>

Children's Health Council, Inc.
Notes to Financial Statements

2. Significant Accounting Policies (continued)

Use of Estimates:

The preparation of 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 disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates include the estimated fair value of CHC's non-marketable investments and the collectability of accounts and pledges receivable.

Concentration of Credit Risk:

Financial instruments that potentially subject CHC to concentration of credit risk consist primarily of cash and cash equivalents, accounts receivable, pledges receivable and investments. CHC maintains its cash and cash equivalents with one major U.S. financial institution and one major brokerage firm. CHC's cash balances with the financial institution are insured by the Federal Deposit Insurance Corporation (FDIC). Cash balances exceeded FDIC insurable limits by \$1,045,000 at June 30, 2017 (\$2,493,000 at June 30, 2016). CHC's cash and investment balances held with the brokerage firm exceeded the amount insured by the Securities Investor Protection Corporation by \$28,748,000 at June 30, 2017 (\$23,360,000 at June 30, 2016). Non-marketable securities of \$2,172,000 at June 30, 2017 (\$2,436,000 at June 30, 2016) are not insured.

Pledge receivables are generally from local donors and these donors' credit worthiness is evaluated by CHC on a regular basis. CHC makes judgements as to the ability to collect its outstanding pledge receivables and provide an allowance for potential credit losses as needed. Credit losses have historically been within management's expectation.

Accounts receivable are recorded at the invoiced amount. The allowance for doubtful accounts is management's best estimate of the amount of probable credit losses in the Company's existing accounts receivable. Management performs ongoing evaluations of its customers' financial condition and generally does not require collateral. The Company maintains reserves for credit losses, and such losses have been within management's expectations.

Children's Health Council, Inc.
Notes to Financial Statements

2. Significant Accounting Policies (continued)

Property and Equipment:

Purchased assets are recorded at cost. Donated assets are recorded at estimated fair value at the date of contribution. Acquisitions of property and equipment with a cost or donated value in excess of \$5,000 are capitalized. Depreciation is computed using the straight-line method over the estimated useful lives of three to five years for equipment, computer software and automobiles; seven years for furniture and fixtures; and 40 to 49 years for the building.

Income Taxes:

CHC has been determined to be exempt from federal and California income taxes under Section 501(c)(3) of the Internal Revenue Code and Section 23701(d) of the California Revenue and Taxation Code, respectively. As a result, no provision for federal or state income taxes has been provided for in the accompanying financial statements.

Although CHC is recognized as tax exempt, it is still liable for income tax on any unrelated business taxable income (UBTI) generated by its non-marketable investments. There was no tax liability relating to UBTI at June 30, 2017 or 2016.

CHC applies the provisions set forth in Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 740 to account for the uncertainty in income taxes. CHC assessed all income tax positions taken where the statute of limitations remained open. Examples of these tax positions include CHC's tax-exempt status and potential sources of UBTI. CHC believes that its tax filing positions will be sustained upon tax examinations; therefore, no liability for unrecognized income tax benefits has been recorded at June 30, 2017 or 2016.

CHC's federal exempt organization business income tax return (Form 990) is subject to examination, generally for three years after it is filed with the Internal Revenue Service. CHC's California exempt organization business income tax return is subject to examination, generally for four years after it is filed with the Franchise Tax Board.

Statements of Functional Expenses:

The costs of providing CHC's various programs and services have been summarized on a functional basis in the Statements of Functional Expenses. Direct expenses are allocated to the related program or service benefited. Indirect expenses are generally allocated based on the direct salaries incurred or square footage used by each program or service benefited.

Children's Health Council, Inc.
Notes to Financial Statements

2. Significant Accounting Policies (continued)

Cash and Cash Equivalents:

For purposes of the Statements of Cash Flows, CHC considers all highly liquid debt instruments purchased with a remaining maturity of three months or less to be cash equivalents.

Permanently restricted cash is restricted cash not available for operations and is included in endowment assets (Note 8).

Investments:

Investments in marketable securities are valued at prices quoted on established securities exchanges.

Non-marketable securities consist of investments in private equity funds, hedge funds and real estate limited partnerships. These investments are subject to restriction on resale, are carried at estimated fair value, as determined by the general partner or fund manager, and are subject to the audit of each investment's financial statements, if available. In determining fair value, the general partner or fund manager gives consideration to recent sales prices of issuers' securities, operating results, financial condition and other pertinent information. Because of the inherent uncertainty of valuations, however, estimated fair values may differ significantly from the values that would have been used had a ready market for the investments existed, and the differences could be material to the financial statements.

Fair Value of Financial Instruments:

CHC uses a three-level hierarchy for fair value measurements based on the nature of inputs used in the valuation of an asset or liability as of the measurement date. The three-level hierarchy prioritizes within the measurement of fair value, the use of market-based information over entity-specific information. Fair value focuses on an exit price and is defined 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. The inputs or methodology used for valuing investments are not necessarily an indication of the risk associated with investing in those investments.

Children's Health Council, Inc.
Notes to Financial Statements

2. Significant Accounting Policies (continued)

Fair Value of Financial Instruments: (continued)

The three-level hierarchy for fair value measurements is defined as follows:

Level I: Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level II: Inputs to the valuation methodology 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.

Level III: Inputs to the valuation methodology, which are significant to the fair value measurement, are unobservable.

An investment's categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

Level III Valuation Techniques:

The valuation of non-marketable investments requires significant judgment by CHC's management due to the absence of quoted market values, inherent lack of liquidity and the long-term nature of such assets. A variety of factors are reviewed by management, including, but not limited to: financing and sales transactions with third parties, current operating performance and future expectations of the particular investment, changes in market outlook, and the third party financing environment.

Valuation Process:

Management determines the fair value measurement valuation policies and procedures, including those for Level III recurring and nonrecurring fair value measurements. Management assesses and approves these policies and procedures. At least annually, management (1) determines whether the current valuation techniques used in fair value measurements are still appropriate and (2) evaluates and adjusts the unobservable inputs used in the fair value measurements based on current market conditions and third-party information.

Children's Health Council, Inc.
Notes to Financial Statements

2. Significant Accounting Policies (continued)

Fair Value of Financial Instruments: (continued)

In May 2015, the FASB issued Accounting Standards Update (ASU) No. 2015-07 (ASU 2015-07), *Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities that Calculate Net Asset Value per Share (or its Equivalent)*. ASU 2015-07 removes the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using net asset value (NAV) per share as a practical expedient. CHC elected to early adopt ASU 2015-07 and applied the standard as of July 1, 2015. Early adoption of this guidance resulted in the removal of NAV instruments from Level III in the fair value hierarchy \$2,095,572 at June 30, 2017 (\$2,359,586 at June 30, 2016).

Land Lease:

CHC leases the land on which its primary facility is located from Leland Stanford Junior University. The lease, which provides for a nominal annual rent, expires in 2046. CHC determined at the inception of the lease in 1995 that the present value of the bargain rent to be received over the lease term was not material to its financial position.

Recent Accounting Pronouncements Not Yet Effective:

Presentation of Financial Statements:

In August 2016, the FASB issued ASU 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*. The standard changes the financial reporting requirements for not-for-profit organizations by reducing the number of net asset classes from three to two (“with donor restriction” and “without donor restriction”); requiring expenses to be reported by function and nature; and providing disclosures on the entity’s operating measures and liquidity. ASU 2016-14 is effective for CHC as of July 1, 2018 and requires a retrospective transition approach for its adoption. CHC is currently evaluating the impact of ASU 2016-14 on its financial statements and related disclosures.

Children's Health Council, Inc.
Notes to Financial Statements

2. Significant Accounting Policies (continued)

Recent Accounting Pronouncements Not Yet Effective: (continued)

Revenue:

In May 2014, the FASB issued ASC Topic 606, *Revenue from Contracts with Customers*. This standard outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers that reflects the consideration to which the entity expects to be entitled in exchange for goods and services. The standard will replace most existing revenue recognition guidance generally accepted in the United States of America. Topic 606 is effective for CHC as of July 1, 2019, and permits the use of either a retrospective or cumulative effect transition method for its adoption. CHC is currently evaluating the effect Topic 606 will have on its financial statements and related disclosures.

Leases:

In February 2016, the FASB issued ASU 2016-02, *Leases*. This standard requires all entities that lease assets under leases with terms of more than 12 months to capitalize the assets and related lease liabilities on the Statement of Financial Position. ASU 2016-02 is effective for CHC as of July 1, 2020 and requires the use of a modified retrospective transition approach for its adoption. CHC is currently evaluating the effect ASU 2016-02 will have in its financial statements and related disclosures. Management expects the assets leased under operating leases, similar to the leases disclosed in Note 9 to the financial statements, will be capitalized together with the related lease obligations on the Statement of Financial Position upon the adoption of ASU 2016-02.

Credit Losses:

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments (ASU 2016-13)*. This standard replaces the incurred credit loss model for the measurement of credit losses on financial assets measured at amortized cost, including accounts receivable, and requires entities to recognize an allowance for credit loss for the difference between the receivable's amortized cost basis and the amount the entity expects to collect. ASU 2016-13 is effective for CHC as of July 1, 2021 and requires the use of a modified-retrospective approach with early adoption permitted. CHC believes the effect of adopting ASU 2016-13 will not have a material effect on its financial statements and related disclosures.

Children's Health Council, Inc.
Notes to Financial Statements

2. Significant Accounting Policies (continued)

Comparative Financial Information:

The financial statements include certain prior year summarized comparative information. Such information does not include sufficient detail to constitute a presentation in conformity with accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with CHC's financial statements as of and for the year ended June 30, 2016, from which the summarized information was derived.

Reclassifications:

Certain prior year balances have been reclassified to conform to current year presentation.

3. Pledges Receivable

Pledges receivable consists of the following at June 30:

	<u>2017</u>	<u>2016</u>
Endowment campaign	\$ 694,016	\$ 820,741
Programs and other	<u>849,027</u>	<u>607,526</u>
	1,543,043	1,428,267
Less discount to net present value	<u>(53,941)</u>	<u>(96,057)</u>
Net contributions receivable	<u>\$ 1,489,102</u>	<u>\$ 1,332,210</u>
Amounts receivable in:		
Less than one year	\$ 451,500	\$ 365,247
One to five years	1,091,543	1,038,020
Greater than five years	<u>-</u>	<u>25,000</u>
	<u>\$ 1,543,043</u>	<u>\$ 1,428,267</u>

Contributions to be received after one year from the financial statement date are reflected at the net present value of estimated future cash flows using a risk-adjusted discount rates ranging from 3% to 5%. Uncollectible promises are expected to be insignificant.

Children's Health Council, Inc.
Notes to Financial Statements

3. Pledges Receivable (continued)

Pledges receivable at June 30, 2017 include receivables from three irrevocable survivor trusts (four at June 30, 2016) where CHC has been named as a remainder beneficiary. Management has recorded the estimated net present value of CHC's interest in the trusts at \$641,000 at June 30, 2017 (\$598,000 at June 30, 2016), based on the current estimated fair value of the trust assets and estimated payments to be made to the lifetime beneficiaries.

4. Investments

CHC's investments as of June 30, 2017 are as follows:

	<u>Level I</u>	<u>Level III</u>	<u>Total</u>
Equity securities:			
Domestic	\$ 11,326,720	\$ -	\$ 11,326,720
International	2,494,666	-	2,494,666
Income funds:			
Domestic	10,711,462	-	10,711,462
Emerging market funds	1,591,460	-	1,591,460
Natural resource funds	1,374,704	-	1,374,704
Absolute return funds	1,006,411	-	1,006,411
Hedge fund	<u>-</u>	<u>76,104</u>	<u>76,104</u>
Fair value investments	<u>\$ 28,505,423</u>	<u>\$ 76,104</u>	<u>\$ 28,581,527</u>

Investments valued using NAV:

Hedge funds	\$ 1,384,926
Private equity funds	524,886
Real estate limited partnerships	<u>185,760</u>
Total investments	<u>\$ 30,667,099</u>

The following table summarizes the quantitative inputs and assumptions used for the investment categorized as Level III under the fair value hierarchy as of June 30, 2017

	<u>Fair Value at June 30, 2017</u>	<u>Valuation Technique</u>	<u>Unobservable Inputs</u>
Hedge fund	\$ 76,104	Market, cost and income approaches	Financial ratios and illiquidity

Children's Health Council, Inc.
Notes to Financial Statements

4. Investments (continued)

CHC's investments as of June 30, 2016 are as follows:

	<u>Level I</u>	<u>Level III</u>	<u>Total</u>
Equity securities:			
Domestic	\$ 10,706,985	\$ -	\$ 10,706,985
International	1,751,275	-	1,751,275
Income funds:			
Domestic	9,018,327	-	9,018,327
Emerging market funds	1,497,628	-	1,497,628
Natural resource funds	356,003	-	356,003
Hedge fund	-	75,557	75,557
Real estate limited partnership	-	969	969
Fair value investments	<u>\$ 23,330,218</u>	<u>\$ 76,526</u>	<u>\$ 23,406,774</u>

Investments valued using NAV:

Hedge funds	\$ 1,512,222
Private equity funds	592,344
Real estate limited partnerships	<u>255,020</u>
Total investments	<u>\$ 25,766,330</u>

The following table summarizes the quantitative inputs and assumptions used for investments categorized as Level III under the fair value hierarchy as of June 30, 2016.

	<u>Fair Value at June 30, 2016</u>	<u>Valuation Technique</u>	<u>Unobservable Inputs</u>
Hedge fund	\$ 75,557	Market, cost and income approaches	Financial ratios and illiquidity
Real estate limited partnership	\$ 969	Market, discounted cash flows and income multiple	Hypothetical liquidation assumption

Children's Health Council, Inc.
Notes to Financial Statements

4. Investments (continued)

The table below presents a roll-forward of the amounts in the Statements of Financial Position for the years ended June 30, 2017 and 2016 (including the change in fair value) for the non-marketable investments classified by CHC within Level III of the fair value hierarchy. When a determination is made to classify an investment within Level III of the fair value hierarchy, the determination is based upon the significance of the unobservable inputs to the overall fair value measurement; however, Level III investments typically include, in addition to the unobservable Level III inputs, observable components (that is, components that are actively quoted or can be validated to market-based sources). The losses in the table may include changes in fair value due in part to observable inputs that are a component of the valuation methodology.

Fair value, June 30, 2015	\$ 183,521
Net investment loss	(5,123)
Unrealized losses included in the Statement of Activities	<u>(101,872)</u>
Fair value, June 30, 2016	76,526
Net investment income	4,535
Distribution from sale of investment	(591)
Unrealized losses included in the Statement of Activities	<u>(4,369)</u>
Fair value, June 30, 2017	<u>\$ 76,104</u>

Children’s Health Council, Inc.
Notes to Financial Statements

4. Investments (continued)

CHC uses NAV to determine the fair value of all the underlying investments which (a) do not have a readily determinable fair value and (b) prepare their financial statements consistent with the measurement principles of an investment company or which have the attributes of an investment company. The following table lists investments valued using NAV by major category:

	<u>Remaining Life</u>	<u>Number of Funds</u>	<u>Fair Value of Investments June 30, 2017</u>	<u>Unfunded Commitments June 30, 2017</u>	<u>Redemption Notice Period</u>
Hedge Funds (A)	Less than 1 year	3	\$ 1,384,926	\$ -	Quarterly with 90 day notice
Private Equity Funds (B)	2-10 years	2	\$ 524,886	\$ 5,511	Not Eligible
Real Estate Limited Partnerships (C)	2-5 years	2	\$ 185,760	\$ 160,126	Not Eligible

(A) Consists of two funds for which redemption was requested subsequent to year end. Fund strategies include global equity and fixed income funds in market neutral strategies.

(B) Venture capital and buyouts in domestic and international funds.

(C) Domestic and international real estate partnerships.

Children’s Health Council, Inc.
Notes to Financial Statements

5. Investment Income (Loss)

Investment income (loss) represents interest, dividends and earnings (losses) from real estate limited partnerships, hedge funds and private equity funds, net of investment management expenses, and net investment gains (losses). Realized gains and losses on investments are calculated as the difference between proceeds received and the original cost of the investment. Unrealized gains and losses represent the difference between the current fair value of the investments and their cost basis if purchased during the year or their fair value at the beginning of the year.

Net investment income consists of the following for the year ended June 30, 2017:

	<u>Interest, Dividends and Earnings</u>	<u>Net Realized/ Unrealized Gain</u>	<u>Investment Management Expenses</u>	<u>Total</u>
Marketable securities	\$ 722,025	\$ 1,553,542	\$ (99,810)	\$ 2,155,757
Non-marketable securities	<u>46,173</u>	<u>195,044</u>	<u>-</u>	<u>241,217</u>
	<u>\$ 768,198</u>	<u>\$ 1,728,586</u>	<u>\$ (99,810)</u>	<u>\$ 2,396,974</u>

Net investment income consists of the following for the year ended June 30, 2016:

	<u>Interest, Dividends and Earnings</u>	<u>Net Realized/ Unrealized Loss</u>	<u>Investment Management Expenses</u>	<u>Total</u>
Marketable securities	\$ 572,754	\$ (694,149)	\$ (95,324)	\$ (216,719)
Non-marketable securities	<u>12,769</u>	<u>(75,689)</u>	<u>-</u>	<u>(62,920)</u>
	<u>\$ 585,523</u>	<u>\$ (769,838)</u>	<u>\$ (95,324)</u>	<u>\$ (279,639)</u>

Children's Health Council, Inc.
Notes to Financial Statements

6. Property and Equipment

Property and equipment consists of the following at June 30:

	<u>2017</u>	<u>2016</u>
Building	\$ 13,313,407	\$ 13,237,263
Equipment	993,882	797,586
Computer software	791,087	776,571
Furniture and fixtures	846,018	779,272
Automobiles	<u>142,937</u>	<u>93,807</u>
	16,087,331	15,684,499
Less accumulated depreciation	<u>(6,429,255)</u>	<u>(5,897,638)</u>
	<u>\$ 9,658,076</u>	<u>\$ 9,786,861</u>

7. Temporarily Restricted Net Assets

Temporarily restricted net assets are restricted for the following purposes at June 30:

	<u>2017</u>	<u>2016</u>
Outpatient clinical programs	\$ 496,501	\$ 320,000
Unappropriated endowment fund income	6,549,591	4,202,285
Restricted for time	<u>465,530</u>	<u>653,599</u>
	<u>\$ 7,511,622</u>	<u>\$ 5,175,884</u>

Net assets were released from donor restrictions by the passage of time or incurring expenses satisfying the restricted purposes as follows for the years ended June 30:

	<u>2017</u>	<u>2016</u>
Time and purpose restrictions accomplished based on stipulations of the donor:		
Outpatient clinical programs	\$ 440,000	\$ 743,262
Parent education	220,000	40,000
School programs	<u>8,000</u>	<u>36,000</u>
	<u>\$ 668,000</u>	<u>\$ 819,262</u>

Children's Health Council, Inc.
Notes to Financial Statements

8. Endowment

CHC's endowment consists of donor restricted endowment funds, accumulated earnings on such funds, and funds designated by the Board of Directors to function as endowments. As required by generally accepted accounting principles, 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.

CHC's Board of Directors has interpreted the State Prudent Management of Institutional Funds Act (SPMIFA) as requiring 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, CHC classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor restricted endowment 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 CHC in a manner consistent with the standard of prudence prescribed by SPMIFA. Once appropriated, these amounts are classified as unrestricted net assets.

In accordance with SPMIFA, CHC considers the following factors in making a determination to appropriate or accumulate donor restricted endowment funds:

- (1) The duration and preservation of the fund;
- (2) The purposes of CHC and the donor restricted endowment fund;
- (3) General economic conditions;
- (4) The possible effect of inflation and deflation;
- (5) The expected total return from income and the appreciation of investments;
- (6) Other resources of CHC;
- (7) CHC's investment policies.

CHC has adopted investment and spending policies, approved by the Board of Directors, for 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. Accordingly, the investment process seeks to achieve an after-cost total real rate of return, including investment income as well as capital appreciation, which exceeds the annual distribution with acceptable levels of risk.

Children's Health Council, Inc.
Notes to Financial Statements

8. Endowment (continued)

Endowment assets are invested in a well-diversified asset mix, which includes mutual funds, private equity funds and limited partnerships, that is intended to result in a consistent rate of return that has sufficient liquidity to make an annual distribution of 5%, while growing the funds, if possible. The long-term targeted asset allocation is: 52% equity securities; 30% fixed income securities; 8% real assets; 8% absolute return; 2% cash and cash equivalents. Endowment assets are subject to asset class diversification and limitation guidelines in order to avoid excessive investment concentration and to protect the portfolio against unfavorable outcomes within an asset class.

CHC's Investment Committee monitors the portfolio's composite investment performance (net of fees) against a composite benchmark consisting of the following unmanaged market indices weighted according to the expected target asset allocations stipulated by the endowment's investment guidelines:

- a) Domestic equity: S&P 500 Index and Russell 2000 Index
- b) International equity: MSCI ACWI ex-US
- c) Fixed income: Barclays Aggregate Index
- d) Real Estate: NAREIT Index
- e) Absolute/Real Return: Barclays 1-3 Year Aggregate Index
- f) Commodities/Natural Resources: Dow Jones UBS Commodity Index
- g) Cash/Cash Equivalents: U.S. T-Bill 30 Day Index

CHC has a policy of appropriating for distribution each year 5% of the permanently restricted assets average fair value of the prior 12 quarters ending March 31 preceding the fiscal year in which the distribution is planned. In establishing this policy, CHC considers the long-term expected return on its investment assets and the nature and duration of the individual endowment funds and relies on a total return strategy in which investment returns are achieved through both realized and unrealized capital appreciation and current yield, such as interest and dividends.

From time to time, the fair value of assets associated with individual donor restricted endowment funds may fall below the level that the donor or SPMIFA requires CHC to retain as a fund of perpetual duration. The fair value of the endowment assets exceeded the value of the original donor gifts at June 30, 2017 and 2016.

Children's Health Council, Inc.
Notes to Financial Statements

8. Endowment (continued)

Endowment assets consist of the following at June 30, 2017:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor restricted endowment funds	\$ -	\$ -	\$ 21,740,930	\$ 21,740,930
Board designated endowment funds	3,811,610	-	-	3,811,610
Unappropriated endowment income	<u>-</u>	<u>6,549,591</u>	<u>-</u>	<u>6,549,591</u>
Total endowment assets	<u>\$ 3,811,610</u>	<u>\$ 6,549,591</u>	<u>\$ 21,740,930</u>	<u>\$ 32,102,131</u>

Endowment assets consist of the following at June 30, 2016:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor restricted endowment funds	\$ -	\$ -	\$ 21,129,245	\$ 21,129,245
Board designated endowment funds	1,764,905	-	-	1,764,905
Unappropriated endowment income	<u>-</u>	<u>4,202,285</u>	<u>-</u>	<u>4,202,285</u>
Total endowment assets	<u>\$ 1,764,905</u>	<u>\$ 4,202,285</u>	<u>\$ 21,129,245</u>	<u>\$ 27,096,435</u>

Children's Health Council, Inc.
Notes to Financial Statements

8. Endowment (continued)

Changes in endowment assets for the year ended June 30, 2017 are as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment assets, beginning of year	\$ 1,764,905	\$ 4,202,285	\$ 21,129,245	\$ 27,096,435
Contributions	-	-	611,685	611,685
Funds designated by board	2,500,000	-	-	2,500,000
Funds appropriated, net	(700,000)	-	-	(700,000)
Net appreciation	<u>246,705</u>	<u>2,347,306</u>	<u>-</u>	<u>2,594,011</u>
Endowment assets, end of year	<u>\$ 3,811,610</u>	<u>\$ 6,549,591</u>	<u>\$ 21,740,930</u>	<u>\$ 32,102,131</u>

Changes in endowment assets for the year ended June 30, 2016 are as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment assets, beginning of year	\$ 2,454,528	\$ 4,443,532	\$ 21,076,796	\$ 27,974,856
Contributions	-	-	52,449	52,449
Funds designated by board	28,192	-	-	28,192
Funds appropriated, net	(695,000)	-	-	(695,000)
Net depreciation	<u>(22,815)</u>	<u>(241,247)</u>	<u>-</u>	<u>(264,062)</u>
Endowment assets, end of year	<u>\$ 1,764,905</u>	<u>\$ 4,202,285</u>	<u>\$ 21,129,245</u>	<u>\$ 27,096,435</u>

Children's Health Council, Inc.
Notes to Financial Statements

9. Commitments

Leases:

CHC has an operating lease for a clinical facility in San Jose, California, which expires in November 2017. CHC may extend the lease for an additional three years at the then current market rate. In April 2017, CHC entered into a lease for a facility in San Jose, California, which expires in June 2020. CHC may extend the lease for up to an additional five years at the then current market rate. Rent expense was \$89,000 for the year ended June 30, 2017 (\$66,000 for the year ended June 30, 2016).

Future minimum rental payments under the leases are as follows for years ending June 30:

2018	\$	492,000
2019		477,000
2020		<u>491,000</u>
Total	\$	<u>1,460,000</u>

10. Government Contracts Receivable

CHC contracts with the County of Santa Clara, California (the County) to provide certain clinical and school services. The County, in turn, is reimbursed by the State of California for these payments. The County's records and reconciliations are subject to final audit and settlement by the State Controller's office. The results of these audits may result in additional payments by the County to CHC. Any amounts collected from the County will be recognized as revenue when received.

As of June 30, 2017, the County has open audits for fiscal years 2003 through 2004 and fiscal years 2008 through 2013. Amounts billed by CHC to the County total \$973,000 for these periods. The collection of excess service billings is dependent upon future State funding becoming available in amounts sufficient for the County to reimburse CHC and the County's other service providers.

Children's Health Council, Inc.
Notes to Financial Statements

11. Employee Benefit Plan

In January 2015, CHC adopted a 401(k) plan for its employees. Employees can elect to participate at any time after employment and contribute up to a maximum of 100% of their annual salaries, not to exceed \$18,000 for employees under age 50, and \$24,000 for employees age 50 and above per year. The plan allows for discretionary employer contributions and a contribution of \$174,000 was made for the year ended June 30, 2017 (\$119,000 in 2016).

12. Subsequent Events

In July 2017, CHC and the Parents Education Network (PEN) signed a grant agreement (the Agreement) under which PEN assigned all of its existing educational and mental health programs to CHC. The Agreement was signed immediately prior to PEN's Plan of Dissolution and Distribution of Assets and represents a tax-free charitable grant of assets under Section 501(c)(3) of the Code and related state statutes. CHC has agreed to operate the programs in furtherance of PEN's primary purpose pursuant to PEN's Articles of Incorporation, as required under the Code, under CHC's Parent, Teacher & Continuing Education division.

Management has reviewed subsequent events and transactions that occurred after the Statement of Financial Position date through the date the financial statements were issued. The financial statements include all events or transactions, including estimates, required to be recognized in accordance with generally accepted accounting principles. Management has determined that there are no unrecognized subsequent events that require additional disclosure.