

Consolidated Financial Statements and OMB Circular A-133,
State of Texas Uniform Grant Management Standards and
Reports Required by the Comptroller General of the
United States and the Rules of the Auditor General of the
State of Florida and Supplementary Information Together with
Reports of Independent Certified Public Accountants

PHOENIX HOUSE FOUNDATION, INC. AND AFFILIATES

For the years ended June 30, 2015 and 2014

PHOENIX HOUSE FOUNDATION, INC. AND AFFILIATES

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Grant Thornton LLP
757 Third Avenue, 9th Floor
New York, NY 10017
T 212.599.0100
F 212.370.4520
GrantThornton.com
[linkd.in/GrantThorntonUS](https://www.linkedin.com/company/grantthorntonus)
twitter.com/GrantThorntonUS

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

To the Board of Directors of
Phoenix House Foundation, Inc. and Affiliates:

Report on the financial statements

We have audited the accompanying consolidated financial statements of Phoenix House Foundation, Inc. and Affiliates (collectively, "PHF&A"), which comprise the consolidated statements of financial position as of June 30, 2015 and 2014, and the related consolidated statements of activities and cash flows for the years 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 consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Phoenix House Foundation, Inc. and Affiliates as of June 30, 2015 and 2014, and the consolidated changes in their net assets and their consolidated cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other matters

Supplementary information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The Schedule of Expenditures of Federal, State of Texas and State of Florida awards for the year ended June 30, 2015, as required by the U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, State of Texas Uniform Grant Management Standards, and Section 215.97, Florida Statutes, and Chapter 10.650, Rules of the State of Florida Auditor General, are presented for purposes of additional analysis and are not a required part of the 2015 consolidated financial statements. Such supplementary information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the 2015 consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the 2015 consolidated financial statements and certain additional procedures. These additional procedures included comparing and reconciling the information directly to the underlying accounting and other records used to prepare the 2015 consolidated financial statements or to the 2015 consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information is fairly stated, in all material respects, in relation to the 2015 consolidated financial statements as a whole.

Other reporting required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report, dated December 1, 2015, on our consideration of PHF&A's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering PHF&A's internal control over financial reporting and compliance.



New York, New York
December 1, 2015

PHOENIX HOUSE FOUNDATION, INC. AND AFFILIATES
Consolidated Statements of Financial Position
As of June 30, 2015 and 2014

	<u>2015</u>	<u>2014</u>
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 3,813,490	\$ 4,801,539
Due from government agencies, net of allowance of approximately \$2,923,000 and \$3,428,000 in 2015 and 2014, respectively	13,041,593	12,827,789
Current portion of contributions receivable, net (Note 5)	484,759	865,978
Other receivables, net of allowance of approximately \$2,697,000 and \$1,831,000 in 2015 and 2014, respectively	3,841,919	4,044,754
Donated goods and inventories, net of allowance of approximately \$0 and \$443,000 in 2015 and 2014, respectively	11,916	147,693
Properties held for sale (Note 7)	6,760,456	313,000
Prepaid expenses	1,843,095	1,805,203
Other assets	709,314	858,903
Current portion of notes receivable (Note 6)	5,000	5,000
Total current assets	<u>30,511,542</u>	<u>25,669,859</u>
Contributions receivable, net (Note 5)	294,794	415,038
Notes receivable (Note 6)	160,000	165,000
Investments, at fair value (Note 4)	5,433,501	16,219,100
Property and equipment, net (Note 7)	48,200,686	55,063,213
Total assets	<u>\$ 84,600,523</u>	<u>\$ 97,532,210</u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Accounts payable and accrued expenses	\$ 16,064,144	\$ 13,266,250
Agency funds (Note 8)	235,523	347,040
Current portion of amounts due to government agencies	5,715,901	2,077,304
Current portion of capital lease obligations	-	12,160
Notes payable (Note 9)	8,000,000	5,200,000
Current portion of long-term debt (Note 10)	2,143,315	2,015,187
Revolving loan fund (Note 11)	100,000	100,000
Total current liabilities	<u>32,258,883</u>	<u>23,017,941</u>
Due to government agencies, net of current portion	3,922,462	8,494,406
Capital lease obligations, net of current portion (Note 7)	-	1,353
Conditional asset retirement obligations	3,403,261	3,228,125
Other liabilities	860,000	-
Long-term debt, net of current portion (Note 10)	9,589,593	11,169,364
Total liabilities	<u>50,034,199</u>	<u>45,911,189</u>
Commitments and contingencies		
NET ASSETS		
Unrestricted	25,506,060	42,035,655
Temporarily restricted	5,989,889	6,514,991
Permanently restricted	3,070,375	3,070,375
Total net assets	<u>34,566,324</u>	<u>51,621,021</u>
Total liabilities and net assets	<u>\$ 84,600,523</u>	<u>\$ 97,532,210</u>

The accompanying notes are an integral part of these consolidated financial statements.

PHOENIX HOUSE FOUNDATION, INC. AND AFFILIATES
Consolidated Statement of Operations and Changes in Net Assets
For the year ended June 30, 2015

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
OPERATING REVENUES AND SUPPORT				
Government contract revenue	\$ 67,037,309	\$ -	\$ -	\$ 67,037,309
Client and third-party revenue (Note 12)	60,838,338	-	-	60,838,338
Donated goods and services	3,118,651	-	-	3,118,651
Grants and contributions	1,626,163	1,506,406	-	3,132,569
Special events revenue, net of costs of direct benefits to donors of approximately \$295,000	-	-	-	-
	1,150,075	-	-	1,150,075
Other revenue	682,052	-	-	682,052
Investment income designated for operations	874,557	-	-	874,557
Net assets released from restrictions	1,569,337	(1,569,337)	-	-
Total operating revenues and support	<u>136,896,482</u>	<u>(62,931)</u>	<u>-</u>	<u>136,833,551</u>
OPERATING EXPENSES				
Salaries	79,998,111	-	-	79,998,111
Employee benefits and payroll taxes	20,129,688	-	-	20,129,688
Consulting and contractual services	10,753,821	-	-	10,753,821
Resident sustenance	7,138,795	-	-	7,138,795
Occupancy costs	9,990,528	-	-	9,990,528
Vehicle costs	1,416,472	-	-	1,416,472
Communications	3,207,678	-	-	3,207,678
Supplies	4,032,366	-	-	4,032,366
Insurance	1,831,257	-	-	1,831,257
Travel	2,128,422	-	-	2,128,422
Interest	681,828	-	-	681,828
Miscellaneous	1,386,881	-	-	1,386,881
Repairs and maintenance	2,552,690	-	-	2,552,690
Depreciation and amortization	4,073,271	-	-	4,073,271
Total operating expenses	<u>149,321,808</u>	<u>-</u>	<u>-</u>	<u>149,321,808</u>
Loss from operations	<u>(12,425,326)</u>	<u>(62,931)</u>	<u>-</u>	<u>(12,488,257)</u>
OTHER ITEMS				
Loss on sale and disposal of properties	(93,644)	-	-	(93,644)
Investment (loss) gain, net of amounts designated for operations	(1,701,828)	49,195	-	(1,652,633)
Accretion of interest on conditional asset retirement obligations	(175,136)	-	-	(175,136)
Loss on write-down of properties (Note 7)	(688,193)	-	-	(688,193)
Depreciation on capital assets funded by government grants	(1,110,023)	-	-	(1,110,023)
Other	(2,500,300)	-	-	(2,500,300)
Total other items	<u>(6,269,124)</u>	<u>49,195</u>	<u>-</u>	<u>(6,219,929)</u>
Deficiency in revenues over expenses	<u>(18,694,450)</u>	<u>(13,736)</u>	<u>-</u>	<u>(18,708,186)</u>
OTHER CHANGES IN NET ASSETS				
Net assets released from restrictions for capital expenditures	1,867,355	(1,867,355)	-	-
Capital contributions	-	1,355,989	-	1,355,989
Government grants for capital assets	297,500	-	-	297,500
Deficiency in revenues over expenses and changes in net assets	<u>(16,529,595)</u>	<u>(525,102)</u>	<u>-</u>	<u>(17,054,697)</u>
Net assets, beginning of year	<u>42,035,655</u>	<u>6,514,991</u>	<u>3,070,375</u>	<u>51,621,021</u>
Net assets, end of year	<u>\$ 25,506,060</u>	<u>\$ 5,989,889</u>	<u>\$ 3,070,375</u>	<u>\$ 34,566,324</u>

The accompanying notes are an integral part of this consolidated financial statement.

PHOENIX HOUSE FOUNDATION, INC. AND AFFILIATES
Consolidated Statement of Operations and Changes in Net Assets
For the year ended June 30, 2014

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
OPERATING REVENUES AND SUPPORT				
Government contract revenue	\$ 65,398,763	\$ -	\$ -	\$ 65,398,763
Client and third-party revenue (Note 12)	65,623,436	-	-	65,623,436
Donated goods and services	3,576,876	-	-	3,576,876
Grants and contributions	1,158,795	1,467,870	-	2,626,665
Special events revenue, net of cost of direct benefits to donors of approximately \$446,000	1,965,600	-	-	1,965,600
Other revenue	445,931	-	-	445,931
Investment income designated for operations	873,086	-	-	873,086
Net assets released from restrictions	2,068,809	(2,068,809)	-	-
Total operating revenues and support	<u>141,111,296</u>	<u>(600,939)</u>	<u>-</u>	<u>140,510,357</u>
OPERATING EXPENSES				
Salaries	75,111,733	-	-	75,111,733
Employee benefits and payroll taxes	20,874,099	-	-	20,874,099
Consulting and contractual services	9,987,771	-	-	9,987,771
Resident sustenance	7,429,150	-	-	7,429,150
Occupancy costs	9,597,501	-	-	9,597,501
Vehicle costs	1,690,339	-	-	1,690,339
Communications	3,320,884	-	-	3,320,884
Supplies	4,238,601	-	-	4,238,601
Insurance	1,663,940	-	-	1,663,940
Travel	2,213,128	-	-	2,213,128
Interest	557,985	-	-	557,985
Miscellaneous	1,557,220	-	-	1,557,220
Repairs and maintenance	2,731,810	-	-	2,731,810
Depreciation and amortization	3,889,783	-	-	3,889,783
Total operating expenses	<u>144,863,944</u>	<u>-</u>	<u>-</u>	<u>144,863,944</u>
Loss from operations	<u>(3,752,648)</u>	<u>(600,939)</u>	<u>-</u>	<u>(4,353,587)</u>
OTHER ITEMS				
Gain on disposal of property	195,348	-	-	195,348
Investment gain, net of amounts designated for operations	700,603	696,730	-	1,397,333
Accretion of interest on conditional asset retirement obligations	(166,344)	-	-	(166,344)
Loss on write-down of property	(113,910)	-	-	(113,910)
Depreciation on capital assets funded by government grants	(944,007)	-	-	(944,007)
Other	127,817	-	(257,739)	(129,922)
Total other items	<u>(200,493)</u>	<u>696,730</u>	<u>(257,739)</u>	<u>238,498</u>
(Deficiency in) excess of revenues over expenses	<u>(3,953,141)</u>	<u>95,791</u>	<u>(257,739)</u>	<u>(4,115,089)</u>
OTHER CHANGES IN NET ASSETS				
Net assets released from restrictions for capital expenditures	655,744	(655,744)	-	-
Capital contributions	-	361,110	-	361,110
Government grants for capital assets	399,996	-	-	399,996
Excess of expenses over revenues and changes in net assets	<u>(2,897,401)</u>	<u>(198,843)</u>	<u>(257,739)</u>	<u>(3,353,983)</u>
Net assets, beginning of year	<u>44,933,056</u>	<u>6,713,834</u>	<u>3,328,114</u>	<u>54,975,004</u>
Net assets, end of year	<u>\$ 42,035,655</u>	<u>\$ 6,514,991</u>	<u>\$ 3,070,375</u>	<u>\$ 51,621,021</u>

The accompanying notes are an integral part of this consolidated financial statement.

PHOENIX HOUSE FOUNDATION, INC. AND AFFILIATES
Consolidated Statements of Cash Flows
For the years ended June 30, 2015 and 2014

	<u>2015</u>	<u>2014</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Changes in net assets	\$ (17,054,697)	\$ (3,353,983)
Adjustments to reconcile changes in net assets to net cash (used in) provided by operating activities:		
Loss (gain) on sale and disposal of properties	93,644	(195,348)
Loss on write-down of property	688,193	113,910
Forgiveness of notes receivable	5,000	5,000
Net realized and unrealized loss (gain) on fair value of investments	858,870	(2,119,098)
Accretion of interest on conditional asset retirement obligations	175,136	166,344
Amortization of discount on contributions receivable	(4,124)	(20,148)
Changes in provision for doubtful accounts	373,319	9,943
Changes in provision for inventory allowance	(443,541)	21,352
Depreciation and amortization	5,183,294	4,833,790
Contributions restricted for capital expenditures and long-term investment	(1,355,989)	(361,110)
Changes in operating assets and liabilities:		
Due from government agencies	282,789	129,378
Receivables	(663,539)	(326,825)
Donated goods and inventories	579,318	22,881
Contributions receivable	502,049	968,713
Prepaid expenses	(37,892)	(355,547)
Other assets	121,816	(90,852)
Accounts payable and accrued expenses	2,797,894	1,612,547
Agency funds	(111,517)	(14,036)
Other liabilities	860,000	-
Due to government agencies	(931,642)	(1,313,636)
Net cash used in operating activities	<u>(8,081,619)</u>	<u>(266,725)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(5,862,598)	(6,312,632)
Proceeds from sale of properties	340,311	-
Proceeds from insurance for fire loss	-	272,959
Proceeds from sales of investments	17,975,310	7,957,602
Purchases of investments	(8,048,581)	(7,565,136)
Net cash provided by (used in) investing activities	<u>4,404,442</u>	<u>(5,647,207)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Contributions restricted for capital expenditures and long-term investment	1,355,989	361,110
Proceeds from long-term debt	868,000	-
Principal payments on long-term debt	(2,319,643)	(664,167)
Principal payments on capital lease obligations	(15,218)	(119,189)
Proceeds from government grants for capital expenditures	-	1,557,732
Proceeds from notes payable	2,800,000	5,438,889
Net cash provided by financing activities	<u>2,689,128</u>	<u>6,574,375</u>
Net (decrease) increase in cash and cash equivalents	(988,049)	660,443
Cash and cash equivalents, beginning of year	4,801,539	4,141,096
Cash and cash equivalents, end of year	<u>\$ 3,813,490</u>	<u>\$ 4,801,539</u>
Supplemental disclosure of cash flow information:		
Interest paid	<u>\$ 682,000</u>	<u>\$ 560,000</u>

The accompanying notes are an integral part of these consolidated financial statements.

PHOENIX HOUSE FOUNDATION, INC. AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2015 and 2014

1. ORGANIZATION

The accompanying consolidated financial statements consist of the accounts and transactions of Phoenix House Foundation, Inc. (the “Parent”) and Affiliates (collectively, “PHF&A”). PHF&A is an organization that is passionate about healing individuals, families and communities challenged by substance use disorders and related mental health conditions.

Phoenix House Foundation, Inc. is the sole member of the following affiliated organizations: Phoenix Houses of New York, Inc. and Affiliates (which consist of Phoenix Houses of New York, Inc. and Phoenix Houses of Long Island, Inc.); Phoenix Houses of California, Inc. and Affiliates (which consist of Phoenix Houses of California, Inc.; Phoenix House Orange County, Inc.; Phoenix Houses of Los Angeles, Inc.; and Phoenix House San Diego, Inc.); Phoenix Houses of the Mid-Atlantic, Inc. and Affiliates (which consist of Phoenix Houses of the Mid-Atlantic, Inc. and Phoenix House Mid-Atlantic Property Management, Inc.); Phoenix Houses of New England, Inc.; Phoenix Houses of Texas, Inc.; Phoenix Programs of Florida, Inc.; American Council for Drug Education, Inc.; Center on Addiction and the Family, Inc.; and Phoenix Houses of New Jersey, Inc. All intercompany balances and transactions have been eliminated in consolidation.

Phoenix House Foundation, Inc. and Affiliates are Section 501(c)(3) not-for-profit organizations exempt from federal income taxes under Section 501(a) of the Internal Revenue Code (the “IRC”) and have been classified as organizations that are not private foundations under Section 509(a) of the IRC. Phoenix House Foundation, Inc. and Affiliates are also exempt from state and local income taxes.

The accompanying 2015 consolidated financial statements reflect a total change in net assets of a negative \$17,054,697 and a negative cash flows from operations totaling \$8,081,619. During fiscal 2015, client admissions in several New York programs and one program in California were temporarily suspended. Although, the admission suspension was lifted by the end of fiscal 2015, the client census at both of these locations has been slow to increase to profitable levels. The presence of these conditions raise concern regarding PHF&A’s ability to continue in operations for the foreseeable future as PHF&A’s continuation is in large part dependent on its ability to generate sufficient cash flows from its operations to provide for its operating costs and to service all existing debt obligations. In response to these factors, PHF&A has closed under-performing facilities, has implemented a plan to monetize certain non-strategic properties, and has secured temporary financing to provide sufficient cash flows to sustain its operations and has embarked on a comprehensive revision to its overall rehabilitative client service strategy.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying consolidated financial statements have been prepared using the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America (“US GAAP”). Accordingly, all significant intercompany accounts and transactions have been eliminated in the accompanying consolidated financial statements. The net assets of PHF&A and changes therein are classified and reported based upon the existence or absence of donor-imposed restrictions as follows:

- Unrestricted net assets represent expendable resources that are used to carry out PHF&A’s operations and are not subject to donor-imposed stipulations.

PHOENIX HOUSE FOUNDATION, INC. AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2015 and 2014

- Temporarily restricted net assets contain donor-imposed restrictions that permit PHF&A to use or expend such resources only as or when specified. Restrictions are satisfied either by the passage of time or by actions of PHF&A.
- Permanently restricted net assets contain donor-imposed restrictions that stipulate that such resources be maintained permanently, but permit PHF&A to expend all of the income for unrestricted purposes or as stipulated by the donor.

Use of Estimates

The preparation of financial statements in conformity with US 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 financial statements and the reported amounts of revenues and expenses during the reporting period. The allowance for doubtful accounts on accounts receivable, the fair value of donated goods and services, amounts due to government agencies, conditional asset retirement obligations, and the fair value of certain investments represent significant accounting estimates reflected in the financial statements. Actual results could differ from those estimates.

Fair Value Measurements

PHF&A adopted guidance that establishes a framework for measuring fair value and expanding disclosures about fair value measurements. This standard provides a consistent definition for fair value which focuses on an exit price between market participants in an orderly transaction. The standard also prioritizes, within the measurement of fair value, the use of market-based information over entity specific information and establishes a three-level hierarchy for fair value measurements based on the transparency of information used in the valuation of the respective asset or liability as of the measurement date. The standard defines three levels of inputs which may be used to measure fair value:

- Level 1: Quoted prices in active markets for identical assets or liabilities. Level 1 assets include equities, foreign equities and U.S. government obligations that are traded on an active exchange market, as well as commercial paper and money market funds.
- Level 2: Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data. Level 2 assets and liabilities include corporate debt securities with quoted market prices that are traded less frequently than exchange-traded instruments.
- Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the asset or liability being measured. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

Fair value estimates are made at a specific point in time, based on available market information and judgments about the financial asset, including estimates of timing, amount of expected future cash flows and the credit standing of the issuer.

PHOENIX HOUSE FOUNDATION, INC. AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2015 and 2014

Cash and Cash Equivalents

PHF&A considers all highly liquid financial instruments with original maturities of three months or less from the date of purchase, other than those held in the investment portfolio for long-term investment purposes, to be cash equivalents.

Investments

The fair value of investments is based on quoted market prices as of the measurement date.

Donated Goods and Inventories

Inventories consist of donated and purchased goods. Inventories are valued at the lower of cost or market. Donated goods are recorded as revenues and assets (at fair value when received) and expenses (when used) on the consolidated financial statements. Food stamps are recorded at face value, which is the same as fair value, as revenues and assets and are charged to resident sustenance when expended.

Contributed Services

PHF&A receives certain contributed services that meet criteria established by accounting principles generally accepted in the United States of America for recognition as contributions. Such services (primarily legal and teaching services) are recorded at fair value, which for fiscal year 2015 and 2014 totaled approximately \$1,644,000 and \$1,482,000, respectively, and are included as part of donated goods and services on the accompanying consolidated statements of operations and changes in net assets.

Property and Equipment

Property and equipment are stated at cost if purchased or at fair value at the date of gift if donated, less accumulated depreciation and amortization. PHF&A capitalizes assets acquired for greater than \$1,000 and with useful lives greater than two years. Depreciation is computed on the straight-line basis over the estimated useful lives of the assets as follows:

Buildings and improvements	4 - 40 years
Furniture, fixtures and equipment	3 - 15 years
Computer equipment and software	3 - 7 years
Vehicles	2 - 5 years

Furniture, fixtures and computer equipment acquired under capital lease arrangements are amortized using the straight-line method over the shorter of the lease term or the estimated life of the asset.

Costs incurred for repairs, maintenance and minor improvements that do not substantially extend an asset's useful life are charged to expense as incurred. Major improvements, which substantially extend the useful lives of assets, are capitalized.

Revenue and Support

Contributions (including unconditional promises to give) are recorded at fair value when received. Revenues and expenses relative to special events are recognized upon occurrence of the respective event. Contributions received with donor stipulations that limit the use of the donated assets are reported as either temporarily restricted or permanently restricted support. Unconditional promises to give, with payments

PHOENIX HOUSE FOUNDATION, INC. AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2015 and 2014

due in future years, are reported as either temporarily restricted or permanently restricted support, discounted to present value using credit adjusted discount rates which articulate with the collection period of the respective pledge. Such discount rates are not subsequently adjusted. When a donor restriction expires, that is, when a time restriction ends or purpose restriction is fulfilled, temporarily restricted net assets are reclassified to unrestricted net assets and reported on the statement of operations and changes in net assets as net assets released from restrictions. Contributions restricted by donors for the acquisition of property and equipment are released from their restrictions when the respective assets are acquired or constructed and placed in service.

Government Contract Revenue

PHF&A operates under various contracts with government agencies which generally cover a one-year period, subject to annual renewal. The terms of these contracts allow the grantors the right to audit the costs incurred thereunder and adjust contract funding based upon, among other things, the amount of program income received. Any costs disallowed by the grantor would be absorbed by PHF&A and any adjustments by grantors would be recorded when amounts are known; however, it is the opinion of PHF&A that disallowances (if any) would be immaterial, and adjustments (if any) would not have a material adverse effect on PHF&A's consolidated financial statements. For the years ended June 30, 2015 and 2014, there were no disallowed costs pertaining to prior year reimbursements recorded in the accompanying consolidated financial statements.

PHF&A's contracts and other program funding arrangements with government agencies are classified as part of unrestricted net asset activities. However, government contracts that provide for the purchase or construction of capital assets are reflected as part of other changes in net assets in the statement of operations and changes in net assets.

PHF&A determines its allowance for amounts due from government agencies and other receivables based on the anticipated net realizable value of collections expected based on historical collection experience.

Client and Third Party Revenue

Inpatient and outpatient services rendered to Medicaid program beneficiaries are reimbursed based on pre-determined rates. Medicaid and managed Medicaid approximated 38% and 37% of total client and third-party revenue for the years ended June 30, 2015 and 2014, respectively. Contracts have been entered into with commercial insurance carriers and reimbursement is based on contracted rates. Client and third-party revenue (including Medicare, Medicaid and Medi-Cal) is recognized as earned when services are provided to clients.

Laws and regulations governing healthcare programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near-term. Noncompliance with such laws and regulations could result in fines, penalties, and exclusion from such programs. The federal government and many states have aggressively increased enforcement under Medicaid antifraud and abuse legislation. PHF&A believes that it is in compliance, in all material respects, with all applicable laws and regulations and, is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. While no such regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation.

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Noncompliance with such laws and regulations could result in repayments of amounts improperly reimbursed, substantial monetary fines, civil and criminal penalties and exclusion from the Medicaid program.

Income Taxes

Guidance in the area of “Accounting for Uncertainty in Income Taxes” under the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification clarifies the accounting for uncertainty in tax positions taken or expected to be taken in a tax return, including issues relating to financial statement recognition and measurement. This standard provides that the tax effects from an uncertain tax position can be recognized in the financial statements only if the position is “more-likely-than-not” to be sustained if the position were to be challenged by a taxing authority. The standard also provides guidance on measurement, classification, interest and penalties, and disclosure. The adoption of this standard by PHF&A has not had an impact on the accompanying consolidated financial statements. The tax years ended 2012 through 2015, inclusive, are still open to audit for both federal and state purposes. PHF&A has processes presently in place to ensure the maintenance of its tax-exempt status; to identify and report unrelated income; to determine its filing and tax obligations in jurisdictions for which it has nexus; and, to identify and evaluate other matters that may be considered tax positions.

Conditional Assets Retirement Obligations

Conditional Asset Retirement Obligations (“CARO”) are legal obligations associated with the retirement of long-lived assets. PHF&A’s CAROs include costs associated with the eventual remediation and abatement of asbestos utilized within the construction of certain of its facilities, and were initially recorded at fair value along with the related asset retirement costs which have been capitalized by increasing the carrying amount of the related assets by the same amount as the liability. For the years ended June 30, 2015 and 2014, the accretion of interest associated with CAROs totaled approximately \$175,000 and \$166,000, respectively. At June 30, 2015 and 2014, property and equipment includes capitalized conditional asset retirement obligations at an approximate cost of \$533,000 and accumulated depreciation of approximately \$533,000 each year. The total CARO liability at June 30, 2015 and 2014 totaled approximately \$3,403,000 and \$3,228,000, respectively. None of the CAROs were settled during fiscal 2015 or 2014.

Statement of Operations and Changes in Net Assets

PHF&A’s operating (loss) income includes all unrestricted revenues and expenses. Other items include gain (loss) on disposal of property, investment gain (loss), net of amounts designated for operations, accretion of interest on conditional asset retirement obligations, loss on write-down of property, depreciation on capital assets funded by government grants and other items. The statement of operations and changes in net assets also includes the caption “(Deficiency in) excess of revenues over expenses,” which is the performance indicator. Other changes in net assets, which are excluded from the performance indicator, consistent with industry practice, include restricted contributions (including assets acquired using contributions which by donor restriction are to be used for the purposes of acquiring or constructing such assets), net assets released from restriction for capital expenditure and government grants for capital assets.

Concentrations of Credit Risk

Cash, cash equivalents and investments are exposed to various risks, such as interest rate, market and credit. To minimize such risks, PHF&A has a diversified investment portfolio in a variety of asset classes managed by an independent investment manager. PHF&A’s cash, cash equivalents and investments are placed with

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high credit quality financial institutions. PHF&A regularly evaluates its investments including performance thereof. Due to inherent risks and potential volatility in investment valuations, the amounts reported on the accompanying consolidated financial statements can vary substantially from year to year. PHF&A maintains its cash in various bank deposit accounts that, at times, may exceed federally insured limits; however, PHF&A does not anticipate nonperformance by these financial institutions.

PHF&A provides drug and alcohol rehabilitation services through its inpatient and outpatient care facilities. PHF&A grants credit without collateral to clients, however, it routinely obtains assignment of (or is otherwise entitled to receive) clients' benefits payable under their health insurance programs, plans, or policies (e.g. Medicaid and commercial insurance providers). Other receivables by financial class as a percentage of total accounts receivable at June 30, 2015 and 2014, are as follows:

	<u>2015</u>	<u>2014</u>
Medicaid	24 %	19 %
Commercial insurance	21	20
Other third-party payors	54	59
Self-pay	<u>1</u>	<u>2</u>
	<u>100 %</u>	<u>100 %</u>

Subsequent Events

PHF&A evaluated its June 30, 2015 consolidated financial statements for subsequent events through December 1, 2015, the date the consolidated financial statements were issued. PHF&A is not aware of any subsequent events which would require recognition or disclosure in the accompanying consolidated financial statements other than what has been disclosed in Notes 3, 7, 10, 13 and 16.

3. RELATED PARTY TRANSACTIONS

Phoenix House Development Fund, Inc. ("Development") is governed and operated independently from PHF&A and is not included in the accompanying consolidated financial statements. Development was organized to provide support for PHF&A. For the years ended June 30, 2015 and 2014, Development's total unrestricted revenues approximated \$175,000 and \$172,000 and operating expenses totaled approximately \$375,000 and \$17,000, including grants to PHF&A of approximately \$365,000 and \$0, respectively. Effective August 14, 2015, the Attorney General of the State of New York approved a plan for dissolution of Development and distribution of its assets to the Phoenix House Foundation, Inc.

Included in receivables at June 30, 2015 and 2014, is approximately \$64,000 and \$11,000, respectively, due from Development.

PHF&A received donated legal services from certain related parties (primarily legal services from law firms of certain board members) totaling approximately \$1,178,000 and \$930,000 for the years ended June 30, 2015 and 2014, respectively, and are recorded as part of donated goods and services and consulting and contractual services on the accompanying consolidated statements of operations and changes in net assets.

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4. INVESTMENTS

Investments, at fair value, at June 30, 2015 and 2014, consist approximately of the following:

	<u>2015</u>	<u>2014</u>
Equities	\$ 2,998,000	\$ 10,286,000
Foreign equities	369,000	2,478,000
U.S. government obligations	1,230,000	2,112,000
Corporate debt	776,000	1,166,000
Commercial paper and money market funds	61,000	144,000
Certificates of deposit	-	33,000
	<u>\$ 5,434,000</u>	<u>\$ 16,219,000</u>

The following table presents PHF&A's investments within the fair value hierarchy as of June 30, 2015:

	<u>Fair value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Equities	\$ 2,998,000	\$ 2,998,000	\$ -	\$ -
Foreign equities	369,000	369,000	-	-
U.S. government obligations	1,230,000	1,230,000	-	-
Corporate debt	776,000	-	776,000	-
Commercial paper and money market funds	61,000	61,000	-	-
Certificates of deposit	-	-	-	-
	<u>\$ 5,434,000</u>	<u>\$ 4,658,000</u>	<u>\$ 776,000</u>	<u>\$ -</u>

The following table presents PHF&A's investments within the fair value hierarchy as of June 30, 2014:

	<u>Fair value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Equities	\$ 10,286,000	\$ 10,286,000	\$ -	\$ -
Foreign equities	2,478,000	2,478,000	-	-
U.S. government obligations	2,112,000	2,112,000	-	-
Corporate debt	1,166,000	-	1,166,000	-
Commercial paper and money market funds	144,000	144,000	-	-
Certificates of deposit	33,000	33,000	-	-
	<u>\$ 16,219,000</u>	<u>\$ 15,053,000</u>	<u>\$ 1,166,000</u>	<u>\$ -</u>

In general, investments are exposed to various risks, such as interest rate, credit and overall market volatility. Due to the level of risk associated with certain investments, it is possible that changes in the values of investments could occur in the near term and such changes could materially affect the amounts reported on the accompanying consolidated financial statements.

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Net investment gains for the years ended June 30, 2015 and 2014 consist approximately of the following:

	<u>2015</u>	<u>2014</u>
Net realized and unrealized (losses) gains	\$ (859,000)	\$ 2,119,000
Interest and dividends	<u>199,000</u>	<u>315,000</u>
	(660,000)	2,434,000
Less: Investment advisory and custodian fees	<u>(118,000)</u>	<u>(164,000)</u>
	<u>\$ (778,000)</u>	<u>\$ 2,270,000</u>

The Parent maintains an investment spending policy which applies to substantially all of its investments. Such investments are managed to achieve a prudent long-term total return. The Parent's Board of Directors established a policy designed to preserve the value of its investments in real terms (after inflation) and provide a predictable flow of funds to support operations and program activities. This policy permits the use of a rate (the spending rate) of 5.5% annually of the average endowment investment portfolio's fair value based on its total return over the previous 20 quarters (see Note 13 for endowment investment spending). In accordance with the spending rate, approximately \$875,000 and \$873,000 of investment income was made available in support of operations in fiscal years 2015 and 2014, respectively.

5. CONTRIBUTIONS RECEIVABLE, NET

At June 30, 2015 and 2014, contributions receivable, net, consist approximately of the following:

	<u>2015</u>	<u>2014</u>
Amounts expected to be collected in:		
Less than one year	\$ 507,000	\$ 868,000
One to five years	<u>331,000</u>	<u>474,000</u>
	838,000	1,342,000
Less: Discount to present value (at rates ranging between 0.28% and 5.11%)	(36,000)	(43,000)
Allowance for uncollectible receivables	<u>(22,000)</u>	<u>(18,000)</u>
	<u>\$ 780,000</u>	<u>\$ 1,281,000</u>

Because of the uncertainty surrounding the collection of certain contributions receivable, management provides an allowance for doubtful accounts based on consideration of the type of receivable, responsible party, the known financial condition of the donor and historical collection patterns. This allowance is maintained at a level management considers adequate to provide for subsequent adjustments and potential uncollectible amounts. These estimates are reviewed periodically and if the financial condition of the responsible party changes significantly, PHF&A will re-evaluate the recoverability of any contributions receivable from that donor. PHF&A writes-off any amounts that are no longer considered to be recoverable, when determined to be appropriate, and any payments subsequently received on such receivables are credited to the statement of operations and changes in net assets.

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6. NOTES RECEIVABLE

PH New England entered into a lease and promissory agreement with the Central Vermont Community Land Trust (“CVCLT”), a non-profit corporation existing under the laws of the State of Vermont. In conjunction with a new program, PH New England agreed to lease a facility from CVCLT for twenty years. As part of the lease agreement, PH New England entered into a non-interest bearing note of \$100,000 payable by CVCLT and secured by a mortgage of and security interest in the property in Barre, Vermont. The principal of this note does not bear interest nor will any principal be due at any time during which the lease between PH New England and CVCLT is in effect and for a period beginning on the date of termination of the lease and ending on the last day of the twelfth calendar month after such date. The principal due shall be reduced by \$5,000 each year for the initial twenty year term of the lease, beginning with the commencement of the new program, beginning July 1, 2013. In the event the lease is in effect throughout the entire initial 20 year term, the note shall be deemed paid in full upon the conclusion of such term. In the event the lease terminates prior to the conclusion of the initial lease term, then the remaining principal shall be due and payable on the last day of the twelfth full calendar month following termination of the lease. Interest shall begin to accrue on such remaining principal balance beginning on the first day of the first month following the due date at a rate equal to the U.S. Department of the Treasury One Year Treasury Bill Rate in effect on the due date. At June 30, 2015 and 2014, the balance of this note receivable was \$90,000 and \$95,000, respectively. The annual rental expense associated with the use of the property described above for the services that PH New England provides to its clients is paid for by the CVCLT.

During July 2010, PH New England entered into a lease and promissory agreement with the Burlington Housing Authority (“BHA”), a housing authority existing under the laws of the State of Vermont and the City of Burlington. In conjunction with a new program, PH New England agreed to lease a facility from BHA for twenty-five years. As part of the lease agreement, PH New England entered into a non-interest bearing note of \$75,000 due and payable by BHA on the last day of the twelfth full calendar month immediately following the termination of the lease. Interest accrues on the principal balance of this note, beginning on the first day of the first month following the Due Date, at a rate equal to the One Year Treasury Bill rate in effect on that date. At June 30, 2015 and 2014, the balance of this note receivable was \$75,000. Rent expense associated with the lease for this space totaled approximately \$52,000 for each of the years ended June 30, 2015 and 2014.

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7. PROPERTY AND EQUIPMENT, NET

At June 30, 2015 and 2014, property and equipment, net, consists approximately of the following:

	<u>2015</u>	<u>2014</u>
Land	\$ 8,806,000	\$ 9,953,000
Buildings and improvements	71,607,000	75,326,000
Furniture, fixtures and equipment	5,410,000	5,093,000
Computer equipment and software	22,433,000	21,561,000
Vehicles	545,000	528,000
Construction-in-progress	<u>3,171,000</u>	<u>8,445,000</u>
	111,972,000	120,906,000
Less: Accumulated depreciation and amortization	<u>(63,771,000)</u>	<u>(65,843,000)</u>
	<u>\$ 48,201,000</u>	<u>\$ 55,063,000</u>

Construction-in-progress at June 30, 2015 consists primarily of renovation costs incurred at the New York facilities. The remaining costs anticipated to complete the renovation projects for the New York facilities total approximately \$5,530,000 and will be funded principally with government contracts. These projects are expected to be completed by fiscal 2017.

During fiscal 2014, a building located at the New York Long Island City facility was destroyed by fire. Accordingly, PHF&A recognized a net gain, inclusive of insurance recoveries, on the disposal of this property of approximately \$195,000.

During fiscal 2015, Phoenix House Foundation's (the "Foundation") Board of Directors passed a resolution to place on the market with the intent to sell its Yorktown property. In connection therewith, the Foundation wrote-down the carrying value of this property to its fair value and recorded an impairment loss of approximately \$672,000, which is recorded as loss on write-down of property and included in other items on the accompanying 2015 consolidated statement of operations and changes in net assets. During November 2015, Foundation entered into a sales agreement with a buyer for the Yorktown property at a selling price of \$6,000,000. During fiscal 2015, Phoenix Houses of California's Board of Directors passed a resolution to place on the market with the intent to sell its Hillview property. No impairment loss was recognized as the carrying value of this property is stated at its net cost, which approximates fair value. During fiscal 2014, PH Mid-Atlantic's Board of Directors passed a resolution to place on the market with the intent to sell its Goldvein Campus, Bealeton House and associated building lots. In connection therewith, PH Mid-Atlantic wrote-down the carrying value of these properties to their current fair value and recorded an impairment loss of approximately \$114,000, which is recorded as loss on write-down of property and included in other items on the accompanying 2014 consolidated statement of operations and changes in net assets. During fiscal 2015, an additional impairment loss of approximately \$16,000 was recorded to write-down the remaining building lots held by PH Mid-Atlantic to their fair values as of June 30, 2015. The properties have been reflected as assets held for sale on the accompanying consolidated

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statements of financial position. PHF&A's properties held for sale is a recurring fair value measurement and is therefore classified as follows at June 30, 2015 and 2014 within the fair value hierarchy:

	2015		2014	
	Fair Value	Level 2	Fair Value	Level 2
Phoenix House Foundation	\$ 6,000,000	\$ 6,000,000	\$ -	\$ -
Phoenix Houses of California, Inc.	654,000	654,000	-	-
Phoenix Houses of Mid-Atlantic, Inc.	106,000	106,000	313,000	313,000
	<u>\$ 6,760,000</u>	<u>\$ 6,760,000</u>	<u>\$ 313,000</u>	<u>\$ 313,000</u>

The inputs used to report the fair value of the properties held for sale have been classified as Level 2 as the valuations are based on values of comparable parcels of property in the same geographical area and pending offers for purchase.

During fiscal 2016, Phoenix House Foundation's Board of Directors passed a resolution to place on the market with the intent to sell its Jack Aron Center ("74th Street") property. During November 2015, the Foundation entered into a sales agreement with a buyer for 74th Street at a selling price of \$28,000,000.

Included in property and equipment are assets acquired under capital lease arrangements with terms ranging from three to five years. At June 30, 2015 and 2014, furniture acquired under capital lease arrangements had a cost of approximately \$170,000 and accumulated amortization of approximately \$170,000 and \$160,000, respectively. Amounts outstanding at June 30, 2015 and 2014 under these capital leases totaled approximately \$0 and \$14,000, respectively.

8. AGENCY FUNDS

Agency funds consist principally of amounts received from government agencies, clients and others attributable and payable to specific individuals in PHF&A's programs. Unexpended funds are to be returned to the respective agencies, clients or grantors. At June 30, 2015 and 2014, funds of approximately \$236,000 and \$347,000, respectively, are held on behalf of others by PHF&A.

9. LINE OF CREDIT AND NOTES PAYABLE

During fiscal 2014, PHF&A reduced its \$12,000,000 line of credit to \$8,000,000 by converting \$4,000,000 to a term loan (see Note 10). At June 30, 2015 and 2014, \$8,000,000 and \$5,200,000, respectively, was outstanding under the line of credit, which bears interest at variable rates based on one month LIBOR plus 1.75%. Interest rates on amounts borrowed ranged from 1.90% to 1.93% and 1.90% to 1.92% during fiscal 2015 and 2014, respectively. The line of credit expires on March 31, 2016.

During fiscal years 2015 and 2014, interest paid on the line of credit amounted to \$132,000 and \$114,000, respectively.

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10. LONG-TERM DEBT

At June 30, 2015 and 2014, long-term debt consists of the following:

- Tax-exempt debt through the California Statewide Communities Development Authority (“CSCDA”) and Wells Fargo Bank, N.A. As of June 30, 2015, the debt had a remaining term of 4-1/2 years to December 15, 2019 and is collateralized by a letter of credit that expires on July 1, 2016. Payments of principal and interest based on 68% of the three-month LIBOR rate plus 1.25% (1.44% and 1.41% at June 30, 2015 and 2014, respectively), calculated on a 25-year basis, are due quarterly. During the years ended June 30, 2015 and 2014, these interest rates ranged from 1.41% to 1.44%. Approximately \$1,267,500 and \$1,583,000 was outstanding at June 30, 2015 and 2014, respectively.
- Tax-exempt debt through the Milam County Health Development Corporation and Wells Fargo Brokerage Services, LLC. Outstanding borrowings are secured by a first mortgage on a treatment facility in Austin, Texas, guaranteed by the Parent, and payable in semiannual installments through April 2017. The rate resets every three years over the term of the loan at a rate equal to 110% of the three-year U.S. treasury interest rate then in effect. The rate is 1.45% effective April 2011 at which time principal and interest installments were adjusted to \$77,000 effective with the October 2011 payment and will be adjusted every three years thereafter to reflect changes in the interest rate. The outstanding balance at June 30, 2015 and 2014 was approximately \$302,000 and \$450,000, respectively.
- Loan payable to the State Bank of Long Island. The loan is collateralized by property located in East Hampton, NY and Ronkonkoma, NY. The loan bears interest at a rate of 6.00% per annum through June 2016 and then at a rate equal to the greater of (a) 6% or (b) the Daily Treasury Yield Curve Rate for a five year maturity on June 27, 2016 plus 3.75% per annum through June 29, 2021. The outstanding balance at June 30, 2015 and 2014 was approximately \$1,974,000 and \$2,045,000, respectively.
- Loan agreement with Citizens Bank of Rhode Island payable in 120 monthly installments with a final balloon payment, including interest amortized over ten years at a rate of 2.59%, due in April 2017. The proceeds of the loan were used to purchase and renovate a building. Amounts due under the mortgage are secured by property purchased in Springfield, MA. At June 30, 2015 and 2014, the balance of the mortgage payable was approximately \$82,000 and \$93,000, respectively.
- Loan agreement with Citizens Bank of Rhode Island payable in 120 monthly installments with a final balloon payment, including interest amortized over fifteen years at a rate of 6.46%, due in July 2018. In November 2015, a modification was made to the loan agreement changing the interest rate to 3.99% effective through the maturity date. All other terms and conditions remain the same. The proceeds of the loan were used to purchase and renovate a building in Holyoke, MA. Amounts due under the mortgage are secured by property in Springfield, MA. At June 30, 2015 and 2014, the balance of the mortgage payable was approximately \$130,000 and \$143,000, respectively.
- Loan agreement with the Virginia Housing Development Authority payable in monthly installments through July 1, 2029. The loan is secured by a facility in Arlington, VA. The loan bears interest at a fixed rate of 5.00% per annum. At June 30, 2015 and 2014, the outstanding balance was approximately \$280,000 and \$293,000, respectively.

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- Loan agreement with the Virginia Housing Development Authority payable in monthly installments through April 1, 2037, at a fixed rate of 6.169%. The loan is secured by a first deed of trust on a building in Arlington, VA. The loan was amended in November 2008 to add the loan balance on the Bealeton, Virginia property with a balance of \$525,000. No increase in rate or principal payments resulted from this amendment. At June 30, 2015 and 2014, the balance of the mortgage payable was approximately \$3,756,000 and \$4,109,000, respectively.
- On September 1, 2011, Phoenix House Mid-Atlantic Property Management, Inc. entered into a Loan agreement with Virginia Commerce Bank. The mortgage is payable in monthly installments of \$5,352 and bears a fixed rate of interest at 5.19%. The loan is secured by a first deed of trust on a building in Arlington, VA. At June 30, 2015 and 2014, the balance of the mortgage payable was approximately \$546,000 and \$580,000, respectively.
- During fiscal 2014, PHF&A reduced its line of credit with JPMorgan Chase Bank, N.A. by converting \$4,000,000 outstanding under the line of credit to a term loan. The term loan is payable in 36 monthly installments of approximately \$111,000 through May 2017 and bears interest at a fixed rate of 2.65%. At June 30, 2015 and 2014, the balance of the term loan was approximately \$2,555,000 and \$3,889,000, respectively.
- On October 1, 2014, PH New England entered into a loan agreement with Old Colony Realty, LLC in the amount of \$400,000 due in 48 monthly installments. The interest rate is fixed at 9.242%. The proceeds of the loan were used to renovate a building in Quincy, MA. At June 30, 2015, the balance of this mortgage payable was approximately \$343,000.
- On November 25, 2014, PH New England entered into a loan agreement with Citizens Bank of Rhode Island in the amount of \$468,000 due in 120 monthly installments with a final balloon payment at the end of the term. The interest rate for years 1-5 is fixed at 3.99%. The interest rate resets in the sixth year of the loan at the Bank's Five Year Cost of Funds plus an additional two hundred and ten basis points (210) effective November 2019 through the term of the loan agreement in April 2024. The proceeds of the loan were used to renovate a building in Quincy, MA. Amounts due under the mortgage are secured by property in Providence, RI. At June 30, 2015, the balance of this mortgage payable was approximately \$459,000.
- On April 9, 2015, PH Texas entered into a loan agreement with Plains Capital Bank for the purchase of two vehicles. The loan is payable in 60 monthly installments through April 9, 2020, at a fixed rate of 5%. At June 30, 2015, the balance of the loan was approximately \$39,000.

Annual principal payments due during the next five years and in total thereafter under the aforementioned borrowings are approximately as follows for the years ended June 30:

2016	\$ 2,143,000
2017	2,117,000
2018	697,000
2019	711,000
2020	292,000
Thereafter	<u>5,773,000</u>
	<u>\$ 11,733,000</u>

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During fiscal years 2015 and 2014, interest paid on these long-term debt agreements amounted to \$548,000 and \$420,000, respectively.

PHF&A's debt agreements contain covenants and amended covenants requiring the maintenance of certain financial ratios, among other restrictions. PHF&A was not in compliance with its financial covenants related to its debt agreement with the Milam County Health Development Corporation and Wells Fargo Brokerage Services, LLC, the outstanding balance of which was approximately \$302,000 as of June 30, 2015. However, subsequent to year-end, with the anticipated sale of its 74th Street property, more fully described in Note 7, PHF&A expects that it will be able to demonstrate compliance with these covenants.

On October 29, 2015, PHF&A entered into a \$10 million loan agreement with 42-50 Jay Street, LLC (Silver Point Capital), with an interest rate of prime +5.75% per annum. On that date, PHF&A borrowed \$10 million (\$9.4 million, net of closing costs) for working capital. This loan is secured by the Jay Street property, and matures on October 29, 2016. The loan can be extended for another year if certain conditions are met.

11. REVOLVING LOAN FUND

PH New England has an agreement, the Rhode Island Revolving Loan Fund Project- R House, with the State of Rhode Island's Department of Mental Health - Retardation and Hospitals to operate a program. The nature of this federally mandated revolving loan fund program is to provide financial assistance loans to residents of group homes for recovering substance abusers. The State of Rhode Island has provided PH New England with \$100,000 to fund these interest-free loans. The revolving loan fund account increases with interest earned on funds on deposit and decreases as a result of uncollectible loans. The loan fund assets are recorded within cash and cash equivalents and other receivables on the accompanying consolidated statements of financial position. The loan is due to the State of Rhode Island upon dissolution of the program. Outstanding loans receivable as of June 30, 2015 and 2014 totaled approximately \$6,400 and \$6,500, respectively.

12. CLIENT AND THIRD-PARTY REVENUE

For the years ended June 30, 2015 and 2014, client and third-party revenue consists approximately of the following:

	<u>2015</u>	<u>2014</u>
Healthcare services	\$ 23,084,000	\$ 24,479,000
Home relief	9,528,000	11,302,000
Aid for Families with Dependent Children funding	6,837,000	7,561,000
Private insurance and client payments	16,738,000	17,345,000
Other client fees	2,380,000	1,782,000
Food stamps	1,629,000	2,337,000
School lunch program	502,000	614,000
Other	140,000	203,000
	<u>\$ 60,838,000</u>	<u>\$ 65,623,000</u>

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13. NET ASSETS AND NET ASSETS RELEASED FROM RESTRICTIONS

At June 30, 2015 and 2014, PHF&A had permanently restricted net assets totaling approximately \$3,070,000 and \$3,070,000, respectively. Earnings on permanently restricted net assets are to be used in support of operations or specified program initiatives, as stipulated by the respective donors.

At June 30, 2015 and 2014, temporarily restricted net assets are restricted for the following purposes:

	<u>2015</u>	<u>2014</u>
Specified program initiatives	\$ 3,487,000	\$ 2,809,000
Capital initiatives	1,736,000	2,519,000
Endowment earnings, awaiting appropriation for expenditure	<u>767,000</u>	<u>1,187,000</u>
	<u>\$ 5,990,000</u>	<u>\$ 6,515,000</u>

Following satisfaction of and in accord with donor-specified use restrictions, during fiscal 2015 and 2014 temporarily restricted net assets totaling approximately \$3,437,000 and \$2,725,000, respectively, were released from restrictions in support of operations and capital initiatives.

The State of New York passed the New York Prudent Management of Institutional Funds Act (“NYPMIFA”), its version of the Uniform Prudent Management of Institutional Funds Act (“UPMIFA”). All not-for-profit organizations formed in New York must apply this law. It was effective for PHF&A’s 2011 fiscal year, and did not result in any reclassification of net assets from unrestricted net assets to temporarily restricted net assets.

PHF&A classifies as permanently restricted net assets: (a) the original value of gifts donated to its permanent endowment, (b) the original value of subsequent gifts to its permanent endowment, and (c) accumulations to its 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 such amounts are appropriated for expenditure by the Board of Directors of PHF&A in a manner consistent with the standard of prudence prescribed by NYPMIFA. In accordance with NYPMIFA, PHF&A considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

- (1) The duration and preservation of the endowment fund;
- (2) The purposes of PHF&A and its donor-restricted endowment fund;
- (3) General economic conditions;
- (4) The possible effect of inflation or deflation;
- (5) The expected total return from income and appreciation of endowment investments;
- (6) Other resources of PHF&A;

PHOENIX HOUSE FOUNDATION, INC. AND AFFILIATES
Notes to Consolidated Financial Statements
June 30, 2015 and 2014

- (7) The investment policies of PHF&A; and
- (8) Where appropriate, alternatives to spending from donor-restricted endowment funds and the possible effects on PHF&A

PHF&A has adopted investment and spending policies 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. This policy permits the use of 5.5% annually of the average endowment investment portfolio's fair value based on its total return over the previous 20 quarters.

The following tables summarize PHF&A's donor-restricted endowment net asset composition by type of fund as of June 30, 2015 and 2014:

	2015		
	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ 767,000	\$ 3,070,000	\$ 3,837,000

	2014		
	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ 1,187,000	\$ 3,070,000	\$ 4,257,000

The following tables summarize the changes in PHF&A's endowment net assets for the years ended June 30, 2015 and 2014:

	2015		
	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	\$ 1,187,000	\$ 3,070,000	\$ 4,257,000
Interest and dividends	49,000	-	49,000
Appropriation of endowment assets for expenditure	(262,000)	-	(262,000)
Investment losses	(207,000)	-	(207,000)
Endowment net assets, end of year	<u>\$ 767,000</u>	<u>\$ 3,070,000</u>	<u>\$ 3,837,000</u>

PHOENIX HOUSE FOUNDATION, INC. AND AFFILIATES
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	2014		
	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	\$ 735,000	\$ 3,328,000	\$ 4,063,000
Write-off of uncollectible pledge	-	(258,000)	(258,000)
Interest and dividends	76,000	-	76,000
Appropriation of endowment assets for expenditure	(245,000)	-	(245,000)
Investment gains	621,000	-	621,000
Endowment net assets, end of year	<u>\$ 1,187,000</u>	<u>\$ 3,070,000</u>	<u>\$ 4,257,000</u>

Subsequent to year end, the PHF&A's Board of Directors passed a resolution to discontinue a program which was partially funded by a donor-restricted endowment gift. Accordingly, the remaining amount of this endowment totaling approximately \$1,900,000, which was restricted for support of this program, will be returned to the donor.

14. TAX-DEFERRED ANNUITY PLAN

PHF&A has a tax-deferred annuity plan for all eligible employees under Section 403(b) of the IRC. Contributions to the plan by PHF&A are equal to 3% to 10% of each active participant's compensation, based on years of service, as defined in the plan agreement. Total contributions to the plan by PHF&A during fiscal 2015 and 2014 totaled approximately \$2,908,000 and \$3,004,000, respectively and are recorded to employee benefits and payroll taxes on the accompanying statements of operations and changes in net assets.

15. FUNCTIONAL EXPENSES

PHF&A provides drug and alcohol rehabilitative healthcare services to clients and related support activities as described in Note 1. Expenses related to providing these services, included in the statements of operations and changes in net assets at June 30, 2015 and 2014, are as follows:

	2015	2014
Program Services		
Residential treatment services	\$ 93,679,127	\$ 92,102,302
Ambulatory treatment services	10,453,345	10,734,752
Healthcare services	8,612,662	6,922,586
Prevention and education services	5,522,729	5,582,631
Supporting Services		
Administration and general	29,363,187	27,676,035
Fundraising	1,690,758	1,845,638
Total expenses	<u>\$ 149,321,808</u>	<u>\$ 144,863,944</u>

PHOENIX HOUSE FOUNDATION, INC. AND AFFILIATES
Notes to Consolidated Financial Statements
June 30, 2015 and 2014

Residential treatment services are costs associated with providing residential care and treatment to clients. Ambulatory treatment services are costs associated with providing treatment on an outpatient basis to clients. Healthcare services are costs associated with providing primary medical and dental treatment to clients. Prevention and education services are costs associated with the dissemination of educational materials related to the prevention of substance abuse and community outreach activities.

Supporting services represent costs for administrative and general support activities not directly related to providing rehabilitation services. Fundraising includes the salaries and related expenses of employees involved in fundraising activities.

16. COMMITMENTS AND CONTINGENCIES

Lease Commitments

PHF&A leases treatment facilities, vehicles and other equipment under various non-cancelable operating leases expiring at various dates through 2025. Total expense under these leases was approximately \$3,985,000 and \$3,225,000 for the years ended June 30, 2015 and 2014, respectively.

Future minimum rental payments due under these leases are approximately as follows for the years ended June 30:

2016	\$ 3,422,000
2017	2,443,000
2018	1,599,000
2019	1,161,000
2020	806,000
Thereafter	<u>2,402,000</u>
	<u>\$ 11,833,000</u>

In addition, PHF&A rents certain treatment facilities under operating leases on a month-to-month or on an annual renewable basis. Total rent expense relating to these facilities totaled approximately \$868,000 and \$610,000 for the years ended June 30, 2015 and 2014, respectively.

Litigation

Subsequent to year-end, Phoenix Houses of California, Inc. and Affiliates entered into an agreement to settle a class action lawsuit in the amount of \$2,350,000. Of that amount, \$1,490,000 will be funded by April 2016 or 30 days after final court approval of the settlement, whichever is later. This amount is included in accounts payable and accrued expenses in the accompanying 2015 consolidated statement of financial position. Funding of the remaining \$860,000 will not be required until August 2016 or 30 days after final settlement, whichever is later. This amount is included in other liabilities in the accompanying 2015 consolidated statement of financial position.

PHF&A is contingently liable under various other claims which have arisen in the ordinary course of its business. In the opinion of management, these claims will be defended as appropriate and are adequately covered by insurance in certain cases. PHF&A believes that the resolution of these matters will not have a material effect on its consolidated financial statements.

PHOENIX HOUSE FOUNDATION, INC. AND AFFILIATES
Notes to Consolidated Financial Statements
June 30, 2015 and 2014

17. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following methods and assumptions are used by PHF&A in estimating the fair values of its financial instruments:

Cash, cash equivalents, receivables, inventories and other assets, accounts payable, accrued expenses and other liabilities: The carrying amounts reported on the accompanying consolidated statements of financial position approximate fair value due to the short term maturity of the instruments.

Investments: The reported fair value of investments in marketable securities is based on quoted market prices.

Long-term debt: The carrying value of PHF&A's variable and fixed-rate long-term debt approximates fair value based on rates currently available to PHF&A for debt with similar terms and maturities.

Properties held for sale: The reported fair value of PHF&A's properties held for sale is based on comparable parcels of property in the same geographic area and functional use, and pending offers for purchase.

Phoenix House Foundation, Inc. and Affiliates
Schedule of Expenditures of Federal, State of Texas and State of Florida Awards
For the year ended June 30, 2015

Award Recipient	Federal/State Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number	Direct or Pass-Through Grantor Number	Federal Expenditures
Federal Awards				
	<i>U. S. Department of Health and Human Services ("DHHS") :</i>			
	Substance Abuse and Mental Health Services Administration			
	Block Grants for Prevention and Treatment of Substance Abuse			
	Passed-through from:			
Phoenix Houses of Los Angeles, Inc.	Los Angeles Department of Public Health, Substance Abuse Prevention and Control	93.959	PH002247; PH02025	\$ 1,856,955
Phoenix House Orange County, Inc.	County of Orange—Health Care Agency	93.959	-	1,090,065
Phoenix House San Diego, Inc.	County of San Diego—Alcohol and Drug Services	93.959	533642	319,999
Phoenix House of California, Inc.	Yolo County Department of Health Services	93.959	2015-00115	150,167
Phoenix Houses of Texas, Inc.	Texas Department of State Health Services	93.959	2014-044835-002; 2014-044835-001; 2015-46438-001; 2015-46438-002	543,590
Phoenix Houses of Texas, Inc.	Texas Department of State Health Services	93.959	2014-044933-001; 2014-044911-001; 2015-046191-001; 2015-046211-001	452,365
Phoenix Houses of Texas, Inc.	Texas Department of State Health Services	93.959	2014-044870-001; 2015-046894-001	140,812
Phoenix Houses of Texas, Inc.	Texas Department of State Health Services	93.959	2014-044702-001; 2015-046402-001	299,330
Phoenix Houses of Texas, Inc.	Texas Department of State Health Services	93.959	2014-044653-001; 2014-044652-001; 2014-044651-001; 2015-046847-003; 2015-046847-001; 2015-046847-002	1,565,732
Phoenix Houses of Texas, Inc.	Texas Department of State Health Services	93.959	2014-044503-001; 2014-044503-002; 2015-046526-001	19,508
Phoenix Houses of Texas, Inc.	Texas Department of State Health Services	93.959	2014-044442-001; 2015-046526-001	79,074
	Total Phoenix Houses of Texas, Inc. pass-through awards Substance Abuse Prevention and Treatment ("SAPT") program			3,100,411
	Passed-through from:			
Phoenix Houses of New England, Inc.	State of New Hampshire Department of Health and Human Services, Division of Public Health	93.959	1024152	1,420,321
Phoenix Houses of New England, Inc.	Rhode Island Department of Behavioral Healthcare, Developmental Disabilities and Hospitals	93.959	3343394	6,820
Phoenix Houses of New England, Inc.	Rhode Island Department of Behavioral Healthcare, Developmental Disabilities and Hospitals	93.959	76100261230	156,660
Phoenix Houses of New England, Inc.	Rhode Island Department of Behavioral Healthcare, Developmental Disabilities and Hospitals	93.959	3342845	11,399
Phoenix Houses of New England, Inc.	Massachusetts Department of Public Health	93.959	INTF2303MM3900617073	103,259
Phoenix Houses of New England, Inc.	Massachusetts Department of Public Health	93.959	INTF2350MM3501123013	59,037
Phoenix Houses of New England, Inc.	Massachusetts Department of Public Health	93.959	INTF2348MM3300221033	150,671
Phoenix Houses of New England, Inc.	Massachusetts Department of Public Health	93.959	INTF2320MM3503713015	150,501
Phoenix Houses of New England, Inc.	Massachusetts Department of Public Health	93.959	SCDPH230453991320000	89,637
Phoenix Houses of New England, Inc.	Vermont Office of Alcohol and Drug Abuse Programs	93.959	INTF2333MM3705208028	140,150
Phoenix Houses of New England, Inc.	Maine Department of Public Health	93.959	03420-A15036P	286,704
	Total Phoenix Houses of New England, Inc. pass-through awards SAPT program			2,575,159

Phoenix House Foundation, Inc. and Affiliates
Schedule of Expenditures of Federal, State of Texas and State of Florida Awards (continued)
For the year ended June 30, 2015

<u>Award Recipient</u>	<u>Federal/State Grantor/Pass-Through Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Direct or Pass-Through Grantor Number</u>	<u>Federal Expenditures</u>
Phoenix Programs of Florida, Inc.	Passed-through from: State of Florida, Department of Children and Families	93.959	CFBHN QA037; QD1A9	\$ 149,442
Phoenix Houses of Long Island, Inc.	Passed-through from: New York State Office of Alcoholism and Substance Abuse Services	93.959	C003715; C004066	4,283,813
Phoenix Houses of New York, Inc.	New York State Office of Alcoholism and Substance Abuse Services	93.959	C003716; C004067	66,323
Total Block Grants for Prevention and Treatment of Substance Abuse (93.959)				<u>13,592,334</u>
<i>Substance Abuse and Mental Health Services – Projects of Regional and National Significance</i>				
Phoenix Houses of Long Island, Inc.	Passed-through from: U.S. Department of Health and Human Services- Substance Abuse and Mental Health Services Administration	93.243	1H79TI024207-01	242,046
Phoenix Houses of New England, Inc.	County of Cheshire, NH Drug Court Program	93.243	-	140,370
Phoenix Houses of Texas, Inc.	Travis County Juvenile Treatment Drug Court	93.243	PS000068VR	3,541
Total Substance Abuse and Mental Health Services -Projects of Regional and National Significance (93.243)				<u>385,957</u>
<i>Comprehensive Community Mental Health Services for Children with Serious Emotional Disturbances (“SED”)</i>				
Phoenix Houses of Los Angeles, Inc.	Passed-through from: Los Angeles County, Department of Mental Health	93.104	-	1,258,035
<i>Substance Abuse and Mental Health Services - Access to Recovery</i>				
Phoenix Houses of New York, Inc.	Passed-through from: Research Foundation for Mental Hygiene	93.275	5H79TI023116; 5H79TI023116-03; 5H79TI023116-04	70,325
Total Substance Abuse and Mental Health Services – Access to Recovery (93.275)				<u>70,325</u>
Total Substance Abuse and Mental Health Services Administration				<u>15,306,651</u>
Administration for Children and Families				
<i>Foster Care – Title IV-E</i>				
Phoenix Houses of San Diego, Inc.	Passed-through from: County of San Diego, Health & Human Services Agency	93.658	AFDC	981,977
Phoenix House Orange County, Inc.	Orange County, Social Services Agency, California Department of Social Services	93.658	AFDC	855
Phoenix Houses of Los Angeles, Inc.	County of Los Angeles, Department of Children and Family Services	93.658	AFDC	5,444,811
Total Administration for Children and Families				<u>6,427,643</u>
Centers for Medicare and Medicaid Services				
<i>Medical Assistance Program</i>				
Phoenix Houses of Los Angeles, Inc.	Passed-through from: County of Los Angeles- Department of Health Services Alcohol and Drug Program Administration	93.778	PH001839A	52,773
Total U.S. Department of Health and Human Services				<u>21,787,067</u>

Phoenix House Foundation, Inc. and Affiliates
Schedule of Expenditures of Federal, State of Texas and State of Florida Awards (continued)
For the year ended June 30, 2015

Award Recipient	Federal/State Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number	Direct or Pass-Through Grantor Number	Federal Expenditures
<i>U.S. Department of Justice ("DOJ") office of Community Policing Services :</i>				
Office of Community Oriented Policing Services				
<i>Edward Byrne Memorial State and Local Enforcement Assistance Discretionary Grants Program</i>				
Passed-through from:				
Phoenix Programs of Florida, Inc.	Drug Abuse Comprehensive Coordinating Office (ARRA)	16.803	Adult Post Adjudicatory Drug	\$ 176,106
Phoenix House Orange County, Inc.	Orange County Healthcare Agency	16.585	-	11,900
<i>Residential Substance Abuse Treatment for State Prisoners</i>				
Phoenix Houses of Texas, Inc.	Office of the Governor, State of Texas Criminal Justice Division	16.593	-	<u>242,000</u>
Total U.S. Department of Justice				<u>430,006</u>
U.S. Department of Agriculture:				
Child Nutrition Cluster				
<i>School Breakfast Program</i>				
Passed-through from:				
Phoenix Houses of New York, Inc.	New York State Department of Education	10.553	LEA 310300990005	33,875
Phoenix Houses of Long Island, Inc.	New York State Department of Education	10.553	LEA 580205990011	14,902
Phoenix Houses San Diego, Inc.	California Department of Education	10.553	37-34371-9014903-01	16,658
Phoenix Houses of Los Angeles, Inc.	California Department of Education	10.553	30-34306-9014887-01	<u>47,365</u>
Total School Breakfast Program				<u>112,800</u>
<i>National School Lunch Program</i>				
Passed-through from:				
Phoenix Houses of New York, Inc.	New York State Department of Education	10.555	LEA 310300990005	62,282
Phoenix Houses of Long Island, Inc.	New York State Department of Education	10.555	LEA 580205990011	9,587
Phoenix Houses of Texas, Inc.	Texas Department of Education	10.555	2272022	141,156
Phoenix Houses of Los Angeles, Inc.	California Department of Education	10.555	37-34371-9014903-01	116,934
Phoenix Houses San Diego, Inc.	California Department of Education	10.555	19-34199-9014895-01	30,937
Phoenix Houses of New England, Inc.	Rhode Island Department of Education	10.555	School Lunch/Snack	28,865
Phoenix Houses of New England, Inc.	Massachusetts Department of Education	10.555	School Lunch/Snack	<u>15,859</u>
Total National School Lunch Program				<u>405,620</u>
Total Child Nutrition Cluster				<u>518,420</u>
<i>Emergency Food Assistance Program</i>				
Passed-through from:				
Phoenix Houses of New York, Inc.	Food Bank of New York	10.569	Donated Food	<u>60,078</u>
Total U.S. Department of Agriculture				<u>578,498</u>
<i>U.S. Department of Veterans Affairs :</i>				
VA Health Administration Center				
Phoenix Houses of New England, Inc.	VA Homeless Providers Grant and Per Diem Program	64.024	08-38-VT	57,319
Department of Homeland Security				
Phoenix Houses of New York, Inc.	Department of Human Services Administration for Children and Families	93.086	90FM0025-01-00/90FM0025-02-02	<u>635,619</u>
Total Expenditures of Federal Awards				<u>\$ 23,488,509</u>

Phoenix House Foundation, Inc. and Affiliates
Schedule of Expenditures of Federal, State of Texas and State of Florida Awards (continued)
For the year ended June 30, 2015

Award Recipient	Federal/State Grantor/Pass-Through Grantor/Program Title	State Identifying Number	Direct or Pass-Through Grantor Number	Federal Expenditures
State of Texas Awards	<i>Dallas Academy</i>			
	Passed-through from:			
Phoenix Houses of Texas, Inc.	Tarrant County Juvenile Department	N/A	-	\$ 33,042
	Total Non-CFDA Amounts			<u>33,042</u>
	<i>SPAT Program- Block Grants for Prevention and Treatment of Substance Abuse</i>			
	Passed-through from:			
Phoenix Houses of Texas, Inc.	Texas Department of State Health Services	N/A	2014-044835-002; 2014-044835-001; 2015-0464438-001; 2015-0464438-002	85,240
Phoenix Houses of Texas, Inc.	Texas Department of State Health Services	N/A	2014-044933-001; 2014-044911-001; 2015-046191-001; 2015-046211-001	70,606
Phoenix Houses of Texas, Inc.	Texas Department of State Health Services	N/A	2014-044870-001; 2015-046894-001	20,854
Phoenix Houses of Texas, Inc.	Texas Department of State Health Services	N/A	2014-044702-001; 2015-046402-001	44,993
Phoenix Houses of Texas, Inc.	Texas Department of State Health Services	N/A	2014-044653-001; 2014-044652-001; 2014-044651-001; 2015-046847-003; 2015-046847-001; 2015-046847002	415,281
Phoenix Houses of Texas, Inc.	Texas Department of State Health Services	N/A	2014-044442-001; 2015-046526-001	<u>20,737</u>
	Total SAPT Program- Block Grants for Prevention and Treatment Substance Abuse			<u>657,711</u>
	<i>Wilmer Adult Treatment Program</i>			
	Passed-through from:			
Phoenix Houses of Texas, Inc.	Dallas County Community Supervision and Corrections Department	-	-	<u>5,116,798</u>
	Total Expenditures of State of Texas Awards			<u>\$ 5,807,551</u>

Phoenix House Foundation, Inc. and Affiliates
Schedule of Expenditures of Federal, State of Texas and State of Florida Awards (continued)
For the year ended June 30, 2015

<u>Award Recipient</u>	<u>Federal/State Grantor/Pass-Through Grantor/Program Title</u>	<u>State Identifying Number</u>	<u>Direct or Pass-Through Grantor Number</u>	<u>Federal Expenditures</u>
State of Florida Awards	State of Florida, Department of Corrections			
Phoenix Programs of Florida, Inc.	Substance Abuse Services	70.016	C2658, C2626, C2669	\$ 3,960,098
	State of Florida, Department of Children and Families			
Phoenix Programs of Florida, Inc.	Substance Abuse Treatment and Aftercare Services for Children	60.102	CFBHN QA037/QD1A9	<u>488,318</u>
	Total Expenditures of State of Florida Awards			<u>\$ 4,448,416</u>

The accompanying note to the schedule of expenditures of Federal, State of Texas, and State of Florida awards should be read in conjunction with this schedule.

PHOENIX HOUSE FOUNDATION, INC. AND AFFILIATES
Note to the Schedule of Expenditures of Federal, State of Texas
and State of Florida Awards
For the year ended June 30, 2015

1. BASIS OF PRESENTATION

The accompanying Schedule of Expenditures of Federal, State of Texas and State of Florida awards includes the Federal, State of Texas and State of Florida grant expenditures of Phoenix House Foundation, Inc. and Affiliates (collectively, "PHF&A") for the year ended June 30, 2015, and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, the State of Texas Uniform Grant Management Standards, Section 215.97, Florida Statutes, and Chapter 10.650, Rules of the State of Florida Auditor General.

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS REQUIRED BY *GOVERNMENT AUDITING STANDARDS*

To the Board of Directors of
Phoenix House Foundation, Inc. and Affiliates:

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the consolidated financial statements of Phoenix House Foundation, Inc. and Affiliates (collectively, “PHF&A”), which comprise the consolidated statement of financial position as of June 30, 2015, and the related consolidated statements of activities and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated December 1, 2015.

Internal control over financial reporting

In planning and performing our audit of the consolidated financial statements, we considered PHF&A’s internal control over financial reporting (“internal control”) to design audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of internal control. Accordingly, we do not express an opinion on the effectiveness of PHF&A’s internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of PHF&A’s consolidated financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in PHF&A’s internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and other matters

As part of obtaining reasonable assurance about whether PHF&A's consolidated financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Intended purpose

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of PHF&A's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering PHF&A's internal control and compliance. Accordingly, this report is not suitable for any other purpose.

A handwritten signature in black ink that reads "Grant Thornton LLP". The signature is written in a cursive, flowing style.

New York, New York
December 1, 2015

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS ON COMPLIANCE FOR EACH MAJOR FEDERAL AND STATE PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY OMB CIRCULAR A-133, STATE OF TEXAS UNIFORM GRANT MANAGEMENT STANDARDS, AND SECTION 215.97, FLORIDA STATUTES, AND CHAPTER 10.650, RULES OF THE STATE OF FLORIDA AUDITOR GENERAL

To the Board of Directors of
Phoenix House Foundation, Inc. and Affiliates:

Report on compliance for each major federal program

We have audited the compliance of Phoenix House Foundation, Inc. and Affiliates (collectively, “PHF&A”) with the types of compliance requirements described in the U.S. Office of Management and Budget’s *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of PHF&A’s major federal programs, the State of Texas Uniform Grant Management Standards that could have a direct and material effect on each of PHF&A’s major State of Texas programs, and, Section 215.97, Florida Statutes and Chapter 10.650, Rules of the State of Florida Auditor General, that could have a direct and material effect on each of PHF&A’s major State of Florida programs for the year ended June 30, 2015. PHF&A’s major federal, State of Texas and State of Florida programs are identified in the summary of auditors’ results section of the accompanying schedule of findings and questioned costs.

Management’s responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to PHF&A’s federal, State of Texas, and State of Florida programs.

Auditor’s responsibility

Our responsibility is to express an opinion on compliance for each of PHF&A’s major federal, State of Texas and State of Florida programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*; the State of Texas Uniform Grant Management Standards; and, Section 215.97, Florida Statutes and Chapter 10.650, Rules of the State of Florida Auditor General.

The above-mentioned standards and OMB Circular A-133, the State of Texas Uniform Grant Management Standards; and, Section 215.97, Florida Statutes and Chapter 10.650, Rules of the State of Florida Auditor General, require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal, State of Texas or State of Florida program occurred. An audit includes examining, on a test basis, evidence about PHF&A's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal, State of Texas and State of Florida program. However, our audit does not provide a legal determination of PHF&A's compliance.

Opinion on each major federal program

In our opinion, PHF&A complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal, State of Texas and State of Florida programs for the year ended June 30, 2015.

Instances of noncompliance

The results of our audit procedures disclosed an instance of noncompliance, described in the accompanying schedule of findings and questioned costs as item 2015-001, that is required to be reported in accordance with OMB Circular A-133. Our opinion on each major federal, State of Texas and State of Florida program is not modified with respect to this matter.

Organization's response to findings

PHF&A's response to our noncompliance finding, which is described in the accompanying schedule of findings and questioned costs, was not subjected to the auditing procedures applied in the audit of compliance, and accordingly, we express no opinion on PHF&A's response.

Report on internal control over compliance

Management of PHF&A is responsible for designing, implementing, and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered PHF&A's internal control over compliance with the types of compliance requirements that could have a direct and material effect on each major federal, State of Texas and State of Florida program to design audit procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal, State of Texas and State of Florida program and to test and report on internal control over compliance in accordance with OMB Circular A-133, State of Texas Uniform Grant Management Standards; and, Section 215.97, Florida Statutes and Chapter 10.650, Rules of the State of Florida Auditor General, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of PHF&A's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal, State of Texas or State of Florida program on a timely basis. A material weakness in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal, State of Texas and State of Florida program will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in PHF&A's internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

We identified a deficiency in internal control over compliance, described in the accompanying schedule of findings and questioned costs as finding 2015-001, that we consider to be a significant deficiency in PHF&A's internal control over compliance.

PHF&A's response to our finding on internal control over compliance, which is described in the accompanying schedule of findings and questioned costs, was not subjected to the auditing procedures applied in the audit of compliance, and accordingly, we express no opinion on PHF&A's response.

The purpose of this Report on Internal Control Over Compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133, the State of Texas Uniform Grant Management Standards; and, Section 215.97, Florida Statutes and Chapter 10.650, Rules of the State of Florida Auditor General. Accordingly, this report is not suitable for any other purpose.

Grant Thornton LLP

New York, New York
March 30, 2016

PHOENIX HOUSE FOUNDATION, INC. AND AFFILIATES
Schedule of Findings and Questioned Costs
For the year ended June 30, 2015

SECTION I – SUMMARY OF AUDITORS’ RESULTS

Consolidated Financial Statements:

Type of auditors’ report issued: Unmodified

Internal control over financial reporting:
 Material weakness(es) identified? ___ yes X no
 Significant deficiency(ies) identified that are not considered to be material weakness(es)? ___ yes X none reported

Noncompliance material to consolidated financial statements noted? ___ yes X no

Federal, State of Texas and State of Florida Awards:

Internal control over the major programs:
 Material weakness(es) identified? ___ yes X no
 Significant deficiencies identified that are not considered to be material weaknesses? X yes ___ none reported

Type of auditors’ report issued on compliance for major programs: Unmodified

Any audit findings disclosed that are required to be reported in accordance with Section 510(a) of OMB Circular A-133, State of Texas Uniform Grant Management Standards or Section 215.97, Florida Statutes and Chapter 10.650, Rules of the State of Florida Auditor General? X yes ___ no

Identification of major programs:

<u>Grantor/Program or Cluster Title</u>	<u>Federal CFDA or State Grant Number</u>
Federal:	
<i>U.S. Department of Health and Human Services</i> Block Grants for Prevention and Treatment of Substance Abuse	93.959
State of Texas:	
<i>Passed-through from Dallas County Community Supervision and Corrections Department</i> Wilmer Adult Treatment Program	N/A
<i>Texas Department of State Health Services</i> Block Grants for Prevention and Treatment of Substance Abuse	N/A
State of Florida:	
<i>State of Florida, Department of Corrections</i> Substance Abuse Services	C2626/ C2658/ C2669

PHOENIX HOUSE FOUNDATION, INC. AND AFFILIATES
Schedule of Findings and Questioned Costs
For the year ended June 30, 2015

The dollar threshold used to distinguish between type A and type B programs was \$704,655 for federal awards and \$300,000 for State of Florida and State of Texas awards for the year ended June 30, 2015.

Auditee qualified as low-risk auditee? X yes no

SECTION II – FINANCIAL STATEMENT FINDINGS

None noted.

SECTION III – FEDERAL, STATE OF TEXAS AND STATE OF FLORIDA AWARD FINDINGS AND QUESTIONED COSTS

Finding 2015-001:

CFDA #93.959 - Phoenix Houses of New England, Inc. - Block Grants for Prevention and Treatment of Substance Abuse - significant deficiency

Compliance Requirement:

Allowable Costs

Criteria or Specific Requirement:

Per 2 CFR 200.303, the entity must establish and maintain effective internal control over the administration of Federal awards that provides reasonable assurance that the entity is managing Federal awards in compliance with Federal Statutes, regulations, and the terms and conditions of the respective Federal award. An appropriate system of established internal controls includes documented signoff on check request forms by the respective project manager, prior to the actual disbursement occurring.

Condition:

As it specifically pertains to the Phoenix Houses of New England, Inc. entity, for one of forty sample check disbursements selected for testing, the check request form was not approved by the respective project manager prior to the disbursement occurring. However, the related expense item was determined to be an allowable program expense for the period.

Cause:

Due to a clerical oversight, the project manager's signature was omitted during their review of a check request form for services charged to the program. This oversight was not caught by the Finance Department prior to final payment processing.

Questioned Costs:

None

Effect:

The internal controls and documentation standards surrounding purchases were not consistently followed.

Recommendation:

Management should review and supplement its existing controls to ensure that all check request forms are approved by the proper supervisor prior to the actual disbursement occurring.

PHOENIX HOUSE FOUNDATION, INC. AND AFFILIATES
Schedule of Findings and Questioned Costs
For the year ended June 30, 2015

View of Responsible Officials and Planned Corrective Action:

Prior to processing any check requests, the Finance Department will return any check request forms to the respective project manager for review and a documented approval prior to processing any items for payment.

PHOENIX HOUSE FOUNDATION, INC. AND AFFILIATES
Summary Schedule of Prior Year Findings
For the year ended June 30, 2015

Finding 2014-001:

State of Texas Program - Block Grants for Prevention and Treatment of Substance Abuse – significant deficiency

Criteria, Condition, and Effect:

Non-Federal entities are prohibited from contracting with or making subawards under covered transactions to parties that are suspended or debarred or whose principals are suspended or debarred. When a non-federal entity enters into a covered transaction with an entity at a lower tier, the non-federal entity must verify that the entity is not suspended or debarred or otherwise excluded. This verification may be accomplished by (1) checking the Excluded Parties List System (EPLS) maintained by the General Services Administration (GSA), (2) collecting a certification from the entity, or (3) adding a clause or condition to the covered transaction with that entity (2 CFR Section 180.300). In addition, grantees are required to obtain a certification regarding debarment and suspension from all parties with whom they contract for goods or services when the amount of the contract is \$100,000 or more.

While PHF&A has procedures in place to review existing and prospective vendors for appropriateness, such review procedures do not include a verification check specifically for covered transactions by checking the EPLS, collecting a certification from the respective entity, or adding a clause or condition to the covered transaction with the entity prior to contracting with the respective vendor.

There is the potential that PHF&A may be contracting with individuals or subcontractors that are suspended or debarred, thus causing PHF&A to be ineligible to receive federally reimbursed funds due to a lack of adherence to policies surrounding suspension and debarment.

Status:

PHF&A has updated its procedures to include the checking of vendors against the Excluded Parties List System and obtaining certifications regarding debarment and suspension from all vendors when the amount of the contract is greater than \$100,000. No instance of noncompliance were identified in 2015.