

Consolidated Financial Statements and Independent Auditor's
Reports as Required by *Title 2 U.S. Code of Federal Regulations*
Part 200, Uniform Administrative Requirements, Cost
Principles, and Audit Requirements for Federal Awards, the
Rules of the Auditor General of the State of Florida and
Government Auditing Standards and Related Information

PHOENIX HOUSE FOUNDATION, INC. AND AFFILIATES

For the years ended June 30, 2016 and 2015

PHOENIX HOUSE FOUNDATION, INC. AND AFFILIATES

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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, 2016 and 2015, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended, and the related notes to the consolidated 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, 2016 and 2015, 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 consolidating schedules of functional expenses for the years ended June 30, 2016 and 2015 and the Schedule of Expenditures of Federal and State of Florida awards for the year ended June 30, 2016, as required by the Title 2 *U.S. Code of Federal Regulations (CFR) Part 200*, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards, 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 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 consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the 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 consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information is fairly stated, in all material respects, in relation to the 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, 2016, 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, 2016

PHOENIX HOUSE FOUNDATION, INC. AND AFFILIATES
Consolidated Statements of Financial Position
As of June 30, 2016 and 2015

	<u>2016</u>	<u>2015</u>
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 43,343,220	\$ 3,813,490
Due from government agencies, net of allowance of approximately \$2,405,000 and \$2,923,000 in 2016 and 2015, respectively	11,530,791	13,041,593
Current portion of contributions receivable, net (Note 5)	435,817	484,759
Other receivables, net of allowance of approximately \$1,974,000 and \$2,697,000 in 2016 and 2015, respectively	2,738,303	3,841,919
Donated goods and inventories	34,795	11,916
Properties held for sale (Note 7)	6,741,024	6,760,456
Prepaid expenses and other assets	2,797,945	2,552,409
Current portion of notes receivable (Note 6)	5,000	5,000
Total current assets	<u>67,626,895</u>	<u>30,511,542</u>
Contributions receivable, net (Note 5)	196,487	294,794
Notes receivable (Note 6)	155,000	160,000
Investments, at fair value (Note 4)	2,934,117	5,433,501
Property and equipment, net (Note 7)	43,317,209	48,200,686
Total assets	<u>\$ 114,229,708</u>	<u>\$ 84,600,523</u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Accounts payable and accrued expenses	\$ 10,895,388	\$ 14,574,144
Agency funds (Note 8)	172,558	235,523
Current portion of amounts due to government agencies	5,688,607	5,715,901
Note payable (Note 9)	-	8,000,000
Current portion of long-term debt (Note 10)	3,443,484	2,143,315
Revolving loan fund (Note 11)	-	100,000
Other current liabilities (Note 16)	2,350,001	1,490,000
Total current liabilities	<u>22,550,038</u>	<u>32,258,883</u>
Due to government agencies, net of current portion	8,397,136	3,922,462
Conditional asset retirement obligations	3,409,758	3,403,261
Other liabilities (Note 16)	-	860,000
Long-term debt, net of current portion (Note 10)	19,830,356	9,589,593
Total liabilities	<u>54,187,288</u>	<u>50,034,199</u>
Commitments and contingencies		
NET ASSETS		
Unrestricted	50,656,351	25,506,060
Temporarily restricted	5,394,331	5,989,889
Permanently restricted	3,991,738	3,070,375
Total net assets	<u>60,042,420</u>	<u>34,566,324</u>
Total liabilities and net assets	<u>\$ 114,229,708</u>	<u>\$ 84,600,523</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, 2016

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
OPERATING REVENUES AND SUPPORT				
Government contract revenue	\$ 71,221,562	\$ -	\$ -	\$ 71,221,562
Client and third-party revenue (Note 12)	54,397,522	-	-	54,397,522
Donated goods and services	2,238,745	-	-	2,238,745
Grants and contributions	1,078,405	1,178,993	-	2,257,398
Special events revenue, net of costs of direct benefits to donors of approximately \$159,000	441,424	-	-	441,424
Other revenue	250,150	-	-	250,150
Investment income designated for operations	465,777	-	-	465,777
Net assets released from restrictions	1,555,704	(1,555,704)	-	-
Total operating revenues and support	<u>131,649,289</u>	<u>(376,711)</u>	<u>-</u>	<u>131,272,578</u>
OPERATING EXPENSES				
Salaries	74,203,562	-	-	74,203,562
Employee benefits and payroll taxes	19,905,500	-	-	19,905,500
Consulting and contractual services	14,773,575	-	-	14,773,575
Resident sustenance	6,630,613	-	-	6,630,613
Occupancy costs	8,657,503	-	-	8,657,503
Vehicle costs	1,106,196	-	-	1,106,196
Communications	3,042,825	-	-	3,042,825
Supplies	3,298,463	-	-	3,298,463
Insurance	2,798,396	-	-	2,798,396
Travel	1,803,574	-	-	1,803,574
Interest	1,308,668	-	-	1,308,668
Miscellaneous	1,216,788	-	-	1,216,788
Repairs and maintenance	2,125,050	-	-	2,125,050
Depreciation and amortization	4,290,989	-	-	4,290,989
Total operating expenses	<u>145,161,702</u>	<u>-</u>	<u>-</u>	<u>145,161,702</u>
Loss from operations	<u>(13,512,413)</u>	<u>(376,711)</u>	<u>-</u>	<u>(13,889,124)</u>
OTHER ITEMS				
Gain on sale and disposal of properties	39,603,927	-	-	39,603,927
Investment (loss) gain, net of amounts designated for operations	(748,287)	82,372	-	(665,915)
Accretion of interest on conditional asset retirement obligations	(6,497)	-	-	(6,497)
Depreciation on capital assets funded by government grants	(772,832)	-	-	(772,832)
Repayment of restricted contributions	-	(395,148)	(1,500,000)	(1,895,148)
Contribution received in assumption of assets and liabilities of Phoenix House Development Fund, Inc. (Note 3)	(279,301)	-	2,421,363	2,142,062
Other	87,454	(8)	-	87,446
Total other items	<u>37,884,464</u>	<u>(312,784)</u>	<u>921,363</u>	<u>38,493,043</u>
Excess of (deficiency in) revenues and support over expenses	<u>24,372,051</u>	<u>(689,495)</u>	<u>921,363</u>	<u>24,603,919</u>
OTHER CHANGES IN NET ASSETS				
Net assets released from restrictions for capital expenditures	778,240	(778,240)	-	-
Capital contributions	-	872,177	-	872,177
Excess of (deficiency in) revenues and support over expenses and other items and changes in net assets	<u>25,150,291</u>	<u>(595,558)</u>	<u>921,363</u>	<u>25,476,096</u>
Net assets, beginning of year	<u>25,506,060</u>	<u>5,989,889</u>	<u>3,070,375</u>	<u>34,566,324</u>
Net assets, end of year	<u>\$ 50,656,351</u>	<u>\$ 5,394,331</u>	<u>\$ 3,991,738</u>	<u>\$ 60,042,420</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, 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 and support over expenses and other items	<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 and support over expenses and other items 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 Statements of Cash Flows
For the years ended June 30, 2016 and 2015

	<u>2016</u>	<u>2015</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Changes in net assets	\$ 25,476,096	\$ (17,054,697)
Adjustments to reconcile changes in net assets to net cash used in operating activities:		
(Gain) loss on sale and disposal of properties	(39,603,927)	93,644
Loss on write-down of property	-	688,193
Forgiveness of notes receivable	5,000	5,000
Net realized and unrealized loss on fair value of investments	276,497	858,870
Accretion of interest on conditional asset retirement obligations	6,497	175,136
Amortization of discount on contributions receivable	(14,346)	(4,124)
Changes in provision for doubtful accounts	(1,241,517)	373,319
Changes in provision for inventory allowance	-	(443,541)
Depreciation and amortization	5,063,821	5,183,294
Contributions restricted for capital expenditures and long-term investment	(3,014,239)	(1,355,989)
Changes in operating assets and liabilities:		
Due from government agencies	1,439,942	282,789
Receivables	1,830,413	(663,539)
Donated goods and inventories	(22,879)	579,318
Contributions receivable	161,313	502,049
Prepaid expenses	(619,909)	83,924
Accounts payable and accrued expenses	(3,466,580)	2,797,894
Agency funds	(62,965)	(111,517)
Other liabilities	1,490,001	860,000
Due to government agencies	3,334,057	(931,642)
Net cash used in operating activities	<u>(8,962,725)</u>	<u>(8,081,619)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(3,905,411)	(5,862,598)
Proceeds from sale of properties	43,719,808	340,311
Proceeds from sales of investments	4,291,655	17,975,310
Purchases of investments	(2,068,768)	(8,048,581)
Net cash provided by investing activities	<u>42,037,284</u>	<u>4,404,442</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Contributions restricted for capital expenditures and long-term investment	3,014,239	1,355,989
Proceeds from long-term debt	14,109,569	868,000
Principal payments on long-term debt	(2,568,637)	(2,319,643)
Principal payments on capital lease obligations	-	(15,218)
Proceeds from note payable	-	2,800,000
Repayment of note payable	(8,000,000)	
Repayment of revolving loan	(100,000)	-
Net cash provided by financing activities	<u>6,455,171</u>	<u>2,689,128</u>
Net increase (decrease) in cash and cash equivalents	39,529,730	(988,049)
Cash and cash equivalents, beginning of year	<u>3,813,490</u>	<u>4,801,539</u>
Cash and cash equivalents, end of year	<u>\$ 43,343,220</u>	<u>\$ 3,813,490</u>
Supplemental disclosure of cash flow information:		
Interest paid	<u>\$ 1,309,000</u>	<u>\$ 682,000</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, 2016 and 2015

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 "Code") and have been classified as organizations that are not private foundations under Section 509(a) of the Code. Phoenix House Foundation, Inc. and Affiliates are also exempt from state and local income taxes.

On April 11, 2016, a new corporation, named "Phoenix House," was incorporated in the State of Minnesota. Phoenix House is a nonprofit corporation, and will seek recognition of its federal tax exempt status as an organization described in Internal Revenue Code § 501(c)(3).

As of July 1, 2016, Phoenix House became the sole corporate member of the following affiliated organizations: Phoenix House Foundation, Inc., Phoenix Houses of California, Inc., Phoenix Houses of New York, Inc., Phoenix Houses of New England, Inc., Phoenix Houses of Texas, Inc., Phoenix Programs of Florida, Inc., and Phoenix Houses of the Mid-Atlantic, Inc. Phoenix House Foundation, Inc. remains the sole corporate member of the American Council for Drug Education, Inc., Center on Addiction and the Family, Inc., and Phoenix Houses of New Jersey, Inc.

The accompanying 2016 consolidated financial statements reflect a loss from operations of \$13,889,124 and a negative cash flows from operations totaling \$8,962,725. 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 existing debt obligations. In response to these factors, PHF&A has closed under-performing facilities, has monetized certain non-strategic properties which for fiscal 2016 resulted in a net gain of approximately \$40 million, has secured financing to provide sufficient cash flows to sustain its operations and has embarked on a comprehensive revision to its overall rehabilitative client service strategy. Management believes that its initiatives will enable PHF&A to return to profitability, maintain operations, and continue to meet its financial obligations.

PHOENIX HOUSE FOUNDATION, INC. AND AFFILIATES
Notes to Consolidated Financial Statements
June 30, 2016 and 2015

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.
- 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.

PHOENIX HOUSE FOUNDATION, INC. AND AFFILIATES
Notes to Consolidated Financial Statements
June 30, 2016 and 2015

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.

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. For fiscal years 2016 and 2015 donated goods and inventories totaled approximately \$266,000 and \$1,475,000, respectively.

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 years 2016 and 2015 totaled approximately \$1,972,000 and \$1,644,000, 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.

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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 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 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.

Amounts due to Government Agencies

As of June 30, 2016, PHF&A has reflected as amounts due to government agencies (non-current) refundable cash advances pertaining to construction projects at its East Hampton, NY facility totaling approximately \$3,900,000, together with approximately \$4,500,000 of amounts refundable to the State of New York, which were originally intended to be used for renovations and betterments to its Yorktown facility. However, during fiscal 2015, PHF&A decided to sell its Yorktown facility and accordingly, intends to refund the advances received using the sales proceeds from the property. As of June 30, 2015, approximately \$4,500,000 pertains to advances for renovations and betterments to the Yorktown facility and other amounts totaling approximately \$1,200,000 related to government contracts. The remaining amounts reflected as current portion of amounts due to government agencies as of June 30, 2016 and 2015 pertain to government contracts in the New York and California regions, principally OASAS and the Los Angeles Department of Mental Health.

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 year ended June 30, 2016, there was approximately \$123,000 of disallowed costs pertaining to prior year reimbursements which have been recorded in the accompanying 2016 consolidated financial statements as part of accounts payable and accrued expenses. 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.

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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 39% and 37% of total client and third-party revenue for the years ended June 30, 2016 and 2015, 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.

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 June 30, 2013, 2014, 2015 and 2016 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, 2016 and 2015, the accretion of interest associated with CAROs totaled approximately \$6,000 and \$175,000,

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respectively. At June 30, 2016 and 2015, 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, 2016 and 2015 totaled approximately \$3,410,000 and \$3,403,000, respectively. None of the CAROs were settled during fiscal 2016 or 2015.

Statement of Operations and Changes in Net Assets

PHF&A's operating loss 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, repayment of refunded contributions, contributions received in the assumption of assets and liabilities of Phoenix House Development Fund, Inc., and other items. The statement of operations and changes in net assets also includes the caption "Excess of (deficiency in) revenues and support over expenses and other items," which is the performance indicator. Other changes in net assets, which are excluded from the performance indicator, consistent with industry practice, include capital 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 and 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 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, 2016 and 2015, are as follows:

	<u>2016</u>	<u>2015</u>
Medicaid	16 %	24 %
Commercial insurance	18	21
Other third-party payors	65	54
Self-pay	<u>1</u>	<u>1</u>
	<u>100 %</u>	<u>100 %</u>

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Reclassification

Certain 2015 financial statement amounts have been reclassified to conform to the 2016 consolidated financial statement presentation. These reclassifications had no effect on total assets, liabilities, net assets, revenues, or expenses as previously reported.

Subsequent Events

PHF&A evaluated its June 30, 2016 consolidated financial statements for subsequent events through December 1, 2016, 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 1, 7, 10 and 16.

3. RELATED PARTY TRANSACTIONS

Effective May 26, 2016, the New York State Department of State issued a certificate dissolving Phoenix House Development Fund, Inc. (“Development”), which was governed and operated independently from PHF&A and was not included in the accompanying consolidated financial statements. Development was organized to provide support for PHF&A. For the years ended June 30, 2016 and 2015, Development’s total unrestricted revenues approximated \$169,000 and \$175,000 and operating expenses totaled approximately \$155,000 and \$375,000, including grants to PHF&A of approximately \$155,000 and \$365,000, respectively. During the fiscal year ended June 30, 2016, Development’s net assets of approximately \$2,142,000 were distributed to the Phoenix House Foundation, Inc.

Included in receivables at June 30, 2015, is approximately \$64,000 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 \$1,472,000 and \$1,178,000 for the years ended June 30, 2016 and 2015, 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.

4. INVESTMENTS

Investments, at fair value, at June 30, 2016 and 2015, consist approximately of the following:

	<u>2016</u>	<u>2015</u>
Equities	\$ 1,785,000	\$ 2,998,000
Foreign equities	280,000	369,000
U.S. government obligations	-	1,230,000
Corporate debt	-	776,000
Commercial paper and money market funds	869,000	61,000
	<u>\$ 2,934,000</u>	<u>\$ 5,434,000</u>

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The following table presents PHF&A's investments within the fair value hierarchy as of June 30, 2016:

	<u>Fair Value</u>	<u>Level 1</u>
Equities	\$ 2,065,000	\$ 2,065,000
Commercial paper and money market funds	<u>869,000</u>	<u>869,000</u>
	<u>\$ 2,934,000</u>	<u>\$ 2,934,000</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>
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	<u>61,000</u>	<u>61,000</u>	<u>-</u>
	<u>\$ 5,434,000</u>	<u>\$ 4,658,000</u>	<u>\$ 776,000</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.

Net investment gains (losses) for the years ended June 30, 2016 and 2015 consist approximately of the following:

	<u>2016</u>	<u>2015</u>
Net realized and unrealized losses	\$ (277,000)	\$ (859,000)
Interest and dividends	<u>120,000</u>	<u>199,000</u>
	(157,000)	(660,000)
Less: Investment advisory and custodian fees	<u>(43,000)</u>	<u>(118,000)</u>
	<u>\$ (200,000)</u>	<u>\$ (778,000)</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 \$466,000 and \$875,000 of investment income was made available in support of operations in fiscal years 2016 and 2015, respectively.

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5. CONTRIBUTIONS RECEIVABLE, NET

At June 30, 2016 and 2015, contributions receivable, net, consist approximately of the following:

	<u>2016</u>	<u>2015</u>
Amounts expected to be collected in:		
Less than one year	\$ 437,000	\$ 507,000
One to two years	<u>218,000</u>	<u>331,000</u>
	655,000	838,000
Less: Discount to present value (at rates ranging between 0.28% and 5.11%)	(22,000)	(36,000)
Allowance for uncollectible receivables	<u>(1,000)</u>	<u>(22,000)</u>
	<u>\$ 632,000</u>	<u>\$ 780,000</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.

6. NOTES RECEIVABLE

During May 2012, Phoenix New England, Inc. (“PH New England”) entered into a lease, with no stated rental payments due, and a promissory agreement with 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, 2016 and 2015, the balance of this note receivable was \$85,000 and \$90,000, respectively. Use of this facility is received free of charge, however, is cancellable by any party to the lease agreement. Given the immaterial amount of the free rent received, the fair value for the right to use this space has not been quantified and recognized in the accompanying consolidated financial statements.

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During July 2010, PH New England entered into a lease and promissory agreement with 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, 2016 and 2015, the balance of this note receivable was \$75,000. Total rent expense associated with the lease for this space totaled approximately \$52,000 for each of the years ended June 30, 2016 and 2015.

7. PROPERTY AND EQUIPMENT, NET

At June 30, 2016 and 2015, property and equipment, net, consists approximately of the following:

	<u>2016</u>	<u>2015</u>
Depreciable assets:		
Buildings and improvements	\$ 63,471,000	\$ 71,607,000
Furniture, fixtures and equipment	5,338,000	5,410,000
Computer equipment and software	21,960,000	22,433,000
Vehicles	<u>558,000</u>	<u>545,000</u>
	91,327,000	99,995,000
Land	8,453,000	8,806,000
Construction-in-progress	<u>5,259,000</u>	<u>3,171,000</u>
	105,039,000	111,972,000
Less: Accumulated depreciation and amortization	<u>(61,722,000)</u>	<u>(63,771,000)</u>
	<u>\$ 43,317,000</u>	<u>\$ 48,201,000</u>

Construction-in-progress at June 30, 2016 and 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 \$37,000,000 of which \$2.3 million has already been advanced and an additional \$24 million is expected to be provided by government funding. The balance of project costs will be provided for through restricted gifts and operating funds. These projects are expected to be completed by fiscal 2023.

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 October 2016, the Foundation entered into a sales agreement with a buyer for the Yorktown property at a selling price of \$7,800,000.

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During fiscal 2015, Phoenix Houses of California’s (“PHC&A”) board 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 was less than its fair market value. The property was sold in February 2016 for approximately \$4,500,000, resulting in a net gain of approximately \$3,800,000.

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. 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 statements of financial position. PHF&A’s properties held for sale are recurring fair value measurements and are therefore classified as follows at June 30, 2016 and 2015 within the fair value hierarchy:

	2016		2015	
	Fair Value	Carrying Value	Fair Value	Carrying Value
Phoenix House Foundation, Inc. (Yorktown)	\$ 7,774,000	\$ 6,000,000	\$ 6,000,000	\$ 6,000,000
Phoenix House Foundation, Inc. (Belle Terre)	1,300,000	635,000	-	-
Phoenix Houses of California, Inc. (Hillview)	-	-	654,000	654,000
Phoenix Houses of Mid-Atlantic, Inc.	106,000	106,000	106,000	106,000
	<u>\$ 9,180,000</u>	<u>\$ 6,741,000</u>	<u>\$ 6,760,000</u>	<u>\$ 6,760,000</u>

The inputs used to report the fair value of the Belle Terre property, which is held for sale, have been classified as Level 2 as the valuation is based on values of comparable parcels of property in the same geographical area and pending offers for similar property purchases. The fair value of the Yorktown property is based on an executed sales agreement which is expected to close during fiscal 2017.

During fiscal 2016, PHF&A sold its Jack Aron Center (“74th Street”), 185th Street, Prospect Place and Hillview properties with aggregate net book values totaling approximately \$3,309,000 for an aggregate sales price, net of selling costs, of approximately \$43,436,000. In addition, PHF&A disposed of certain fixed assets with net book values of approximately \$523,000. In connection with these sales and disposals, PHF&A recognized net gains of approximately \$39,604,000.

Included in property and equipment are assets acquired under capital lease arrangements with terms ranging from three to five years. At June 30, 2016 and 2015, furniture acquired under capital lease arrangements had a cost of approximately \$170,000 and accumulated amortization of approximately \$170,000, respectively. No amounts were outstanding at June 30, 2016 and 2015 under these capital leases.

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, 2016 and 2015, funds of approximately \$173,000 and \$236,000, respectively, are held on behalf of others by PHF&A.

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9. LINE OF CREDIT AND NOTE 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, \$8,000,000 was outstanding under the line of credit, which bore interest at variable rates based on one month LIBOR plus 1.75%. Interest rates on amounts borrowed ranged from 1.93% to 4.02% and 1.90% to 1.93% during fiscal 2016 and 2015, respectively. The line of credit expired on March 31, 2016.

During fiscal years 2016 and 2015, interest paid on the line of credit amounted to \$158,000 and \$132,000, respectively.

10. LONG-TERM DEBT

At June 30, 2016 and 2015, long-term debt consists of the following:

- Tax-exempt debt through the California Statewide Communities Development Authority (“CSCDA”) and Wells Fargo Bank, N.A. PHC&A’s performance under the debt agreement is guaranteed by the Parent. As of June 30, 2016, the debt had a remaining term of 3-1/2 years to December 15, 2019 and is collateralized by a money market account at Wells Fargo Bank. Payments of principal and interest are based on 68% of the three-month LIBOR rate plus 1.25% (1.68% and 1.44% at June 30, 2016 and 2015, respectively), calculated on a 25-year basis, and are due quarterly. During the years ended June 30, 2016 and 2015, these interest rates ranged from 1.68% to 1.41%. Approximately \$767,000 and \$1,268,000 is outstanding at June 30, 2016 and 2015, 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 interest 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 was set to 1.45% effective April 2011 at which time semiannual principal and interest installments were adjusted to \$77,000 effective with the October 2011 payment. The rate was set to 1.01% effective April 2014 at which time semiannual principal and interest installments were adjusted to \$76,000 effective with the October 2014 payment and will remain effective for the remaining three years of the loan. The outstanding balance at June 30, 2016 and 2015 is approximately \$152,000 and \$302,000, respectively.
- Loan payable to the Valley National Bank. 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, 2016 and 2015 was approximately \$1,899,000 and \$1,974,000, 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, 2016 and 2015, the balance of the mortgage payable was approximately \$70,000 and \$82,000, respectively.

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- 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, 2016 and 2015, the balance of the mortgage payable was approximately \$115,000 and \$130,000, 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, 2016 and 2015, the outstanding balance was approximately \$260,000 and \$280,000, respectively.
- 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, 2016 and 2015, the balance of the mortgage payable was approximately \$3,683,000 and \$3,756,000, 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, 2016 and 2015, the balance of the mortgage payable was approximately \$509,000 and \$546,000, 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, 2016 and 2015, the balance of the term loan was approximately \$1,222,000 and \$2,555,000, 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, 2016 and 2015, the balance of this mortgage payable was approximately \$251,000 and \$343,000, respectively.
- 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, 2016 and 2015, the balance of this mortgage payable was approximately \$443,000 and \$459,000, respectively.

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- 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, 2016 and 2015, the balance of the loan was approximately \$32,000 and \$39,000, respectively.
- During fiscal year 2016, PH Mid-Atlantic entered into loan agreements with Ally Financial, Inc. for the purchase of three vehicles. The loans are payable in 48 monthly installments through September 3, 2019 at annual rate of 4.95% to 5.85%. At June 30, 2016, the aggregate balance of the loans totaled approximately \$93,000.
- 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 plus 5.75% per annum. The loan is secured by the Jay Street property, was originally set to mature on October 29, 2016. Subsequent to year-end, the loan has since been extended to mature on October 29, 2018. At June 30, 2016, the balance of the loan was \$10,000,000.
- During fiscal 2016, PHF&A converted \$4,000,000 outstanding under the then existing line of credit with JPMorgan Chase Bank, N.A. to a term loan. The term loan is payable in 36 monthly installments of approximately \$111,000 through July 2018 and bears interest at a fixed rate of 2.94%. At June 30, 2016, the balance of the term loan was approximately \$3,778,000.

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:

2017	\$ 3,443,000
2018	1,988,000
2019	11,771,000
2020	298,000
2021	295,000
Thereafter	<u>5,479,000</u>
	<u>\$ 23,274,000</u>

During fiscal years 2016 and 2015, interest paid on these aforementioned long-term debt agreements amounted to approximately \$1,147,000 and \$548,000, respectively.

11. REVOLVING LOAN FUND

PH New England had 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 was to provide financial assistance loans to residents of group homes for recovering substance abusers. The State of Rhode Island had 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 was due to the State of Rhode Island upon dissolution of the program. The program was dissolved in 2016 and the available loan funds were paid back

PHOENIX HOUSE FOUNDATION, INC. AND AFFILIATES
Notes to Consolidated Financial Statements
June 30, 2016 and 2015

to the State of Rhode Island. Outstanding loans receivable as of June 30, 2016 and 2015 totaled approximately \$1,900 and \$6,400, respectively.

12. CLIENT AND THIRD-PARTY REVENUE

For the years ended June 30, 2016 and 2015, client and third-party revenue consists approximately of the following:

	<u>2016</u>	<u>2015</u>
Healthcare services	\$ 21,044,000	\$ 23,084,000
Home relief	7,555,000	9,528,000
Aid for Families with Dependent Children funding	5,611,000	6,837,000
Private insurance and client payments	17,479,000	16,738,000
Other client fees	1,348,000	2,380,000
Food stamps	994,000	1,629,000
School lunch program	333,000	502,000
Other	34,000	140,000
	<u>\$ 54,398,000</u>	<u>\$ 60,838,000</u>

13. NET ASSETS AND NET ASSETS RELEASED FROM RESTRICTIONS

At June 30, 2016 and 2015, PHF&A had permanently restricted net assets totaling approximately \$3,992,000 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, 2016 and 2015, temporarily restricted net assets are restricted for the following purposes:

	<u>2016</u>	<u>2015</u>
Specified program initiatives	\$ 1,530,000	\$ 3,487,000
Capital initiatives	3,808,000	1,736,000
Endowment earnings, awaiting appropriation for expenditure	56,000	767,000
	<u>\$ 5,394,000</u>	<u>\$ 5,990,000</u>

Following satisfaction of and in accord with donor-specified use restrictions, during fiscal 2016 and 2015 temporarily restricted net assets totaling approximately \$2,334,000 and \$3,437,000, 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.

PHOENIX HOUSE FOUNDATION, INC. AND AFFILIATES
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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;
- (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

The following tables summarize PHF&A's donor-restricted endowment net asset composition by type of fund as of June 30, 2016 and 2015:

	2016		
	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ 56,000	\$ 3,992,000	\$ 4,048,000

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

PHOENIX HOUSE FOUNDATION, INC. AND AFFILIATES
Notes to Consolidated Financial Statements
June 30, 2016 and 2015

The following tables summarize the changes in PHF&A's endowment net assets for the years ended June 30, 2016 and 2015:

	2016		
	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	\$ 767,000	\$ 3,070,000	\$ 3,837,000
Addition from Development dissolution	-	2,422,000	2,422,000
Return of endowment gift for discontinued program	(295,000)	(1,500,000)	(1,795,000)
Interest and dividends	82,000	-	82,000
Appropriation of endowment assets for expenditure	(268,000)	-	(268,000)
Investment losses	(230,000)	-	(230,000)
Endowment net assets, end of year	<u>\$ 56,000</u>	<u>\$ 3,992,000</u>	<u>\$ 4,048,000</u>

	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>

During fiscal 2016, PHF&A's Board of Directors passed a resolution to discontinue a program which was partially funded by donor-restricted gifts. Accordingly, the remaining amount of unspent gifts for this program totaling approximately \$1,900,000, consisting of a permanently restricted endowment gift of \$1,500,000, together with the accumulated unspent earnings therefrom totaling approximately \$295,000, along with another temporarily restricted gift of \$100,000, were returned to the donors.

During fiscal 2016, Phoenix House Development Fund, Inc. was dissolved and its permanently restricted net assets were distributed to the Phoenix House Foundation, Inc., pursuant to a certificate issued by the New York State Department of State (see also Note 3). These endowment gifts had a balance of approximately \$2,421,000 at June 30, 2016.

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 through December 31, 2015 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. Effective January 1, 2016, the plan was amended and currently provides annual safe harbor non-elective contributions of 3.5% of eligible compensation and a 50% match on participant contributions (maximum match is 2.5%).

PHOENIX HOUSE FOUNDATION, INC. AND AFFILIATES
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June 30, 2016 and 2015

Total contributions to the plan by PHF&A during fiscal 2016 and 2015 totaled approximately \$2,702,000 and \$2,908,000, 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 consolidated statements of operations and changes in net assets at June 30, 2016 and 2015, are as follows:

	<u>2016</u>	<u>2015</u>
Program Services		
Residential treatment services	\$ 90,534,987	\$ 93,679,127
Ambulatory treatment services	9,927,983	10,453,345
Healthcare services	8,880,416	8,612,662
Prevention and education services	4,697,693	5,522,729
Supporting Services		
Administration and general	29,961,441	29,363,187
Fundraising	<u>1,159,182</u>	<u>1,690,758</u>
Total expenses	<u>\$ 145,161,702</u>	<u>\$ 149,321,808</u>

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 \$4,165,000 and \$3,985,000 for the years ended June 30, 2016 and 2015, respectively.

PHOENIX HOUSE FOUNDATION, INC. AND AFFILIATES
Notes to Consolidated Financial Statements
June 30, 2016 and 2015

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

2017	\$ 3,039,000
2018	2,079,000
2019	2,076,000
2020	93,000
2021	66,000
Thereafter	<u>147,000</u>
	<u>\$ 7,500,000</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 \$820,000 and \$868,000 for the years ended June 30, 2016 and 2015, respectively.

Litigation

During fiscal year 2015, Phoenix Houses of California, Inc. and Affilates (“PHC&A”) entered into an agreement to settle a class action lawsuit in the amount of \$2,350,000 pertaining to certain employment practices. Of that amount, \$1,490,000 was expected to be funded by April 2016, and was therefore included in other current liabilities in the 2015 consolidated statement of financial position. The remaining \$860,000 was expected to be funded by August 2016, and was reflected as other liabilities (non-current) in the 2015 consolidated statement of financial position. During fiscal 2016, PHC&A decided to fund the entire amount payable in October 2016, and has therefore, included the obligation as other current liabilities in the accompanying 2016 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.

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 as of the reporting date.

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, credit quality, 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.

SUPPLEMENTARY INFORMATION

PHOENIX HOUSE FOUNDATION, INC. AND AFFILIATES
Supplemental Information - Consolidating Schedule of Functional Expenses
For the year ended June 30, 2016

	Program Services				Supporting Services					
	Residential Treatment Services	Ambulatory Treatment Services	Healthcare Services	Prevention and Education Services	Total	Administration and General	Fund-raising	Cost of Direct Benefits to Donors	Total	Total
Salaries	\$ 46,726,873	\$ 5,752,797	\$ 4,496,074	\$ 2,867,620	\$ 59,843,364	\$ 13,741,320	\$ 618,878	\$ -	\$ 14,360,198	\$ 74,203,562
Employee benefits and payroll taxes	12,950,517	1,537,131	1,143,203	880,614	16,511,465	3,252,895	141,140	-	3,394,035	19,905,500
Consulting and contractual services	5,409,506	561,789	1,314,406	238,657	7,524,358	7,013,839	235,378	-	7,249,217	14,773,575
Resident sustenance	6,111,075	63,659	453,716	1,719	6,630,169	-	444	-	444	6,630,613
Occupancy costs	5,631,963	1,049,985	412,414	235,294	7,329,656	1,300,344	27,503	-	1,327,847	8,657,503
Vehicle costs	813,455	45,155	16,787	8,117	883,514	222,682	-	-	222,682	1,106,196
Communications	2,071,594	259,372	141,709	116,526	2,589,201	425,727	27,897	-	453,624	3,042,825
Supplies	2,261,153	204,391	352,919	139,682	2,958,145	283,388	56,930	-	340,318	3,298,463
Insurance	1,826,965	163,705	115,459	70,881	2,177,010	619,104	2,282	-	621,386	2,798,396
Travel	881,554	108,321	78,953	105,621	1,174,449	607,627	21,497	159,054	788,178	1,962,627
Interest	431,535	9	23,151	-	454,695	853,973	-	-	853,973	1,308,668
Miscellaneous	410,320	45,487	50,856	25,981	532,644	658,804	25,340	-	684,144	1,216,788
Repairs and maintenance	1,794,469	82,074	153,883	6,150	2,036,576	87,652	822	-	88,474	2,125,050
Depreciation and amortization	3,214,008	54,108	126,886	831	3,395,833	894,086	1,071	-	895,157	4,290,990
Total functional expenses	90,534,987	9,927,983	8,880,416	4,697,693	114,041,079	29,961,441	1,159,182	159,054	31,279,677	145,320,756
Less: Costs of direct benefits to donors for special events	-	-	-	-	-	-	-	(159,054)	(159,054)	(159,054)
Total expenses reported by function	\$ 90,534,987	\$ 9,927,983	\$ 8,880,416	\$ 4,697,693	\$ 114,041,079	\$ 29,961,441	\$ 1,159,182	\$ -	\$ 31,120,623	\$ 145,161,702

This schedule should be read in conjunction with the accompanying report of independent certified public accountants and the consolidated financial statements and notes thereto.

PHOENIX HOUSE FOUNDATION, INC. AND AFFILIATES
Supplemental Information - Consolidating Schedule of Functional Expenses
For the year ended June 30, 2015

	Program Services					Supporting Services				
	Residential Treatment Services	Ambulatory Treatment Services	Healthcare Services	Prevention and Education Services	Total	Administration and General	Fund-raising	Cost of Direct Benefits to Donors	Total	Total
Salaries	\$ 48,611,733	\$ 6,178,654	\$ 4,966,002	\$ 3,371,663	\$ 63,128,052	\$ 16,038,359	\$ 831,700	\$ -	\$ 16,870,059	\$ 79,998,111
Employee benefits and payroll taxes	12,978,028	1,565,040	1,151,570	917,869	16,612,507	3,342,237	174,944	-	3,517,181	20,129,688
Consulting and contractual services	3,642,795	534,440	746,974	308,276	5,232,485	5,212,142	309,194	-	5,521,336	10,753,821
Resident sustenance	6,769,091	59,335	302,711	4,457	7,135,594	2,144	1,057	-	3,201	7,138,795
Occupancy costs	6,987,911	1,177,452	332,536	323,173	8,821,072	1,141,855	27,601	-	1,169,456	9,990,528
Vehicle costs	1,118,027	48,883	13,472	147	1,180,529	235,880	63	-	235,943	1,416,472
Communications	2,191,553	262,997	146,395	124,096	2,725,041	448,822	33,815	-	482,637	3,207,678
Supplies	2,481,803	237,907	526,988	254,645	3,501,343	445,717	85,306	360	531,383	4,032,726
Insurance	1,380,305	97,284	75,119	56,097	1,608,805	220,503	1,949	-	222,452	1,831,257
Travel	1,091,824	118,583	55,394	103,053	1,368,854	675,129	84,439	284,965	1,044,533	2,413,387
Interest	438,820	4	16,993	-	455,817	226,011	-	-	226,011	681,828
Miscellaneous	388,527	46,151	33,244	51,184	519,106	729,109	138,666	9,411	877,186	1,396,292
Repairs and maintenance	2,199,620	79,049	163,703	7,100	2,449,472	102,265	953	-	103,218	2,552,690
Depreciation and amortization	3,399,090	47,566	81,561	969	3,529,186	543,014	1,071	-	544,085	4,073,271
Total functional expenses	93,679,127	10,453,345	8,612,662	5,522,729	118,267,863	29,363,187	1,690,758	294,736	31,348,681	149,616,544
Less: Costs of direct benefits to donors for special events	-	-	-	-	-	-	-	-	(294,736)	(294,736)
Total expenses reported by function	<u>\$ 93,679,127</u>	<u>\$ 10,453,345</u>	<u>\$ 8,612,662</u>	<u>\$ 5,522,729</u>	<u>\$ 118,267,863</u>	<u>\$ 29,363,187</u>	<u>\$ 1,690,758</u>	<u>\$ -</u>	<u>\$ 31,053,945</u>	<u>\$ 149,321,808</u>

This schedule should be read in conjunction with the accompanying report of independent certified public accountants and the consolidated financial statements and notes thereto.

Phoenix House Foundation, Inc. and Affiliates
Schedule of Expenditures of Federal and State of Florida Awards
For the year ended June 30, 2016

<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>
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.	County of Los Angeles—Department of Health Services Alcohol and Drug Program Administration	93.959	PH002247; PH02025	\$ 696,840
Phoenix House Orange County, Inc.	County of Orange—Health Care Agency	93.959	-	1,210,980
Phoenix Houses of California, Inc.	Yolo County Department of Health Services	93.959	2015-00115	87,711
	Total Phoenix Houses of California, Inc. pass-through awards Substance Abuse Prevention and Treatment (“SAPT”) program			<u>1,995,531</u>
			2015-046847-003 SA/TRY	
			2015-046847-002 SA/TRY	
			2015-046847-001 SA/TRY	
Phoenix Houses of Texas, Inc.	Texas Department of State Health Services	93.959	2016-048519 SA TRY	1,201,292
			2015-046796-001 SA TRA	
			2016-048408-001 SATRA	
			2016-048474-001 SA TRA	
			2016-048478-001 SA TRA	
			2016-048481-001 SA TRA	
			2016-048448-001 SA TRA	
Phoenix Houses of Texas, Inc.	Texas Department of State Health Services	93.959	2016-048491-001 SA TRA	649,299
Phoenix Houses of Texas, Inc.	Texas Department of State Health Services	93.959	2016-048500-001	2,204
Phoenix Houses of Texas, Inc.	Texas Department of State Health Services	93.959	2015-046526-001 SA TRF	9,645
			2015-046191-001 SA/YPS	
			2015-046191-001 SA/YPS	
			2015-046211-001 SA/YPS	
Phoenix Houses of Texas, Inc.	Texas Department of State Health Services	93.959	2016-048017-001 SA/YPS	547,095
			2015-046402-001 SA/YPI	
Phoenix Houses of Texas, Inc.	Texas Department of State Health Services	93.959	2016-048211-001 SA/YPI	329,511
			2015-046438-001 SA/YPU	
			2016-048068-001 SA/YPU	
			2015-046438-002 SA/YPU	
Phoenix Houses of Texas, Inc.	Texas Department of State Health Services	93.959	2016-048069-001 SA/YPU	569,351
Phoenix Houses of Texas, Inc.	Texas Department of State Health Services	93.959	2015-046894-001 SA/CCP2016-047903-001 SA/CCP	122,368
	Total Phoenix Houses of Texas, Inc. pass-through awards Substance Abuse Prevention and Treatment program			<u>3,430,765</u>
	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	693,252
Phoenix Houses of New England, Inc.	Rhode Island Department of Behavioral Healthcare, Developmental Disabilities and Hospitals	93.959	3342845	73,532
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	INTF2320M03160824027	318,876
Phoenix Houses of New England, Inc.	Massachusetts Department of Public Health	93.959	SCDPH230453991320000	161,495
Phoenix Houses of New England, Inc.	Massachusetts Department of Public Health	93.959	INTF2333MM3705208028	136,822
Phoenix Houses of New England, Inc.	Vermont Office of Alcohol and Drug Abuse Programs	93.959	03420-A16020S	276,704
	Total Phoenix Houses of New England, Inc. pass-through awards SAPT program			<u>1,811,352</u>

Phoenix House Foundation, Inc. and Affiliates
Schedule of Expenditures of Federal and State of Florida Awards (continued)
For the year ended June 30, 2016

Award Recipient	Federal/State Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number	Direct or Pass-Through Grantor Number	Federal Expenditures
Phoenix Programs of Florida, Inc.	Passed-through from: State of Florida, Department of Children and Families	93.959	CFBHN QB037/QD1A9	\$ 309,223
Phoenix Houses of Long Island, Inc.	Passed-through from: New York State Office of Alcoholism and Substance Abuse Services	93.959	C004066	4,981,050
	Total Block Grants for Prevention and Treatment of Substance Abuse			<u>12,527,921</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 (“DHHS”)- Substance Abuse and Mental Health Services Administration	93.243	1H79TI024207-01	149,041
Phoenix Houses of New England, Inc.	County of Cheshire, NH Drug Court Program	93.243	-	154,805
Phoenix Programs of Florida, Inc.	Hillsborough County Board of County Commissioners	93.243	-	54,504
	Total Substance Abuse and Mental Health Services -Projects of Regional and National Significance			<u>358,350</u>
	<i>Comprehensive Community Mental Health Services for Children with Serious Emotional Disturbances (“SED”)</i>			
Phoenix Houses of Los Angeles, Inc.	Passed-through from: Department of Health and Human Services	93.104	-	<u>1,238,540</u>
	<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	H79TI023116	<u>24,125</u>
	Total Substance Abuse and Mental Health Services Administration			<u>14,148,936</u>
	Administration for Children and Families			
	<i>Foster Care – Title IV-E</i>			
Phoenix House San Diego, Inc.	Passed-through from: County of San Diego, Health and Human Services Agency	93.658	AFDC	107,832
Phoenix Houses of Los Angeles, Inc.	County of Los Angeles, Department of Children and Family Services	93.658	DMH - Wrap Around - FFS-12-1534	389,806
Phoenix Houses of Los Angeles, Inc.	County of Los Angeles, Department of Children and Family Services	93.658	AFDC	5,544,932
	Total DHHS Foster Care—Title IV-E			<u>6,042,570</u>
	<i>Promoting Safe and Stable Families</i>			
Phoenix Houses of Texas, Inc.	Passed-through from: Texas Department of Family and Protective Services	93.556	-	<u>976</u>
	<i>Healthy Marriage Promotion and Responsible Fatherhood Grants</i>			
Phoenix Houses of New York, Inc.	Passed-through from: Department of Human Services Administration for Children and Families	93.086	90FM0025-04-00 90FM0110-01-00	<u>415,841</u>
	<i>Social Services Block Grant</i>			
Phoenix Houses of Texas, Inc.	Office of the Governor, State of Texas Criminal Justice Division	93.667	-	<u>11,756</u>

Phoenix House Foundation, Inc. and Affiliates
Schedule of Expenditures of Federal and State of Florida Awards (continued)
For the year ended June 30, 2016

Award Recipient	Federal/State Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number	Direct or Pass-Through Grantor Number	Federal Expenditures
	Centers for Medicare and Medicaid Services			
	<i>Medical Assistance Program</i>			
	Passed-through from:			
Phoenix Houses of Los Angeles, Inc.	County of Los Angeles- Department of Health Services Alcohol and Drug Program Administration	93.778	PH001839A	\$ 83,433
	Total U.S. Department of Health and Human Services			<u>20,703,512</u>
	U.S. Department of Agriculture:			
	Child Nutrition Cluster			
	<i>School Breakfast Program</i>			
	Passed-through from:			
Phoenix Houses of Long Island, Inc.	New York State Department of Education	10.553	LEA 580205990011	260
Phoenix House San Diego, Inc.	California Department of Education	10.553	37-34371-9014903-01	2,614
Phoenix Houses of Los Angeles, Inc.	California Department of Education	10.553	30-34306-9014887-01	43,939
	Total School Breakfast Program			<u>46,813</u>
	<i>National School Lunch Program</i>			
	Passed-through from:			
Phoenix Houses of Long Island, Inc.	New York State Department of Education	10.555	LEA 580205990011	395
Phoenix Houses of Los Angeles, Inc.	California Department of Education	10.555	37-34371-9014903-01	112,124
Phoenix House San Diego, Inc.	California Department of Education	10.555	19-34199-9014895-01	4,812
Phoenix Houses of New England, Inc.	Rhode Island Department of Education	10.555	School Lunch/Snack	11,797
Phoenix Houses of New England, Inc.	Massachusetts Department of Education	10.555	School Lunch/Snack	8,043
	Total National School Lunch Program			<u>137,171</u>
	Total Child Nutrition Cluster			<u>183,984</u>
	<i>Child & Adult Care Food Program</i>			
	Passed-through from:			
Phoenix Houses of Texas, Inc.	Texas Department of Agriculture	10.588	Child & Adult Care Food Program	149,350
	<i>Residential Substance Abuse Treatment for State Prisoners</i>			
	Passed-through from:			
Phoenix Houses of New York, Inc.	Emergency Food Assistance Program, Passed Through from Food Bank of New York	10.569	Donated Food	9,689
	Total U.S. Department of Agriculture			<u>343,023</u>
	U.S. Department of Veterans Affairs :			
	VA Health Administration Center			
Phoenix Houses of New England, Inc.	VA Homeless Providers Grant and Per Diem Program	64.024	08-38-VT	53,590
	Total Expenditures of Federal Awards			<u>\$ 21,100,125</u>

Phoenix House Foundation, Inc. and Affiliates
Schedule of Expenditures of Federal and State of Florida Awards (continued)
For the year ended June 30, 2016

<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	\$ <u>3,980,005</u>
Phoenix Programs of Florida, Inc.	Drug Abuse Comprehensive Coordinating Office	N/A	LEA 580205990011	170,388
Phoenix Programs of Florida, Inc.	Florida Alcohol and Drug Abuse Association	N/A	37-34371-9014903-01	22,032
Phoenix Programs of Florida, Inc.	Volusia County Drug Court	N/A	30-34306-9014887-01	<u>22,800</u>
	Total Drug Court Expansion Program			<u>215,220</u>
	State of Florida, Department of Children and Families			
Phoenix Programs of Florida, Inc.	Substance Abuse Treatment and Aftercare Services for Children	N/A	N/A	<u>319,800</u>
	Total Expenditures of State of Florida Awards			<u>\$ 4,515,025</u>

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

PHOENIX HOUSE FOUNDATION, INC. AND AFFILIATES
Notes to the Schedule of Expenditures of Federal and
State of Florida Awards
For the year ended June 30, 2016

1. BASIS OF PRESENTATION

The accompanying Schedule of Expenditures of Federal and State of Florida awards includes the Federal, and State of Florida grant expenditures of Phoenix House Foundation, Inc. and Affiliates (collectively, "PHF&A") for the year ended June 30, 2016, and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of Title 2 *U.S. Code of Federal Regulations (CFR) Part 200*, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards, Section 215.97, Florida Statutes, and Chapter 10.650, Rules of the State of Florida Auditor General.

2. INDIRECT COST RATE

PHF&A has elected not to use the 10-percent de-minimus indirect cost rate allowed under the Uniform Guidance.

3. SUBRECIPIENTS

PHF&A did not make any disbursements to subrecipients during the year ended June 30, 2016.

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, 2016, and the related consolidated statements of operations and changes in net assets 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, 2016.

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.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings and questioned costs, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies in 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 financial statements will not be prevented, or detected and corrected, on a timely basis. We consider the deficiency described in the accompanying schedule of findings and questioned costs as item 2016-001 to be a material weakness in PHF&A’s internal control.

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. We consider the deficiency described in the accompanying schedule of findings and questioned costs as item 2016-002 to be a significant deficiency in PHF&A's internal control.

Compliance and other matters

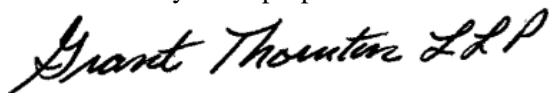
As part of obtaining reasonable assurance about whether PHF&A's consolidated financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material 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*.

Organization's response to findings

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

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.



New York, New York
December 1, 2016

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS ON COMPLIANCE FOR EACH MAJOR FEDERAL AND STATE OF FLORIDA PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY THE UNIFORM GUIDANCE, 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 and State of Florida programs

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 Compliance Supplement* that could have a direct and material effect on each of PHF&A’s major federal 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, 2016. PHF&A’s major federal and State of Florida programs are identified in the summary of auditor’s results section of the accompanying schedule of findings and questioned costs.

Management’s responsibility

Management is responsible for compliance with federal and State of Florida statutes, regulations, and the terms and conditions of its federal and State of Florida awards applicable to PHF&A’s federal 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 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; and the audit requirements of Title 2 *U.S. Code of Federal Regulations Part 200 Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance); Section 215.97, Florida Statutes and Chapter 10.650, Rules of the State of Florida Auditor General. Those standards and the Uniform Guidance, 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 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 and State of Florida program. However, our audit does not provide a legal determination of PHF&A's compliance.

Opinion on each major federal and State of Florida programs

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 and State of Florida programs for the year ended June 30, 2016.

Report on internal control over compliance

Management of PHF&A is responsible for establishing 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 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 and State of Florida program and to test and report on internal control over compliance in accordance with the Uniform Guidance, 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 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 or State of Florida program will not be prevented, or detected and corrected, on a timely basis. A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal or State of Florida program 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.

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 the Uniform Guidance, 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.



New York, New York
March 31, 2017

PHOENIX HOUSE FOUNDATION, INC. AND AFFILIATES
Schedule of Findings and Questioned Costs
For the year ended June 30, 2016

SECTION I - SUMMARY OF AUDITOR'S RESULTS

Consolidated Financial Statements:

Type of auditor's report issued: Unmodified

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

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

Federal 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? ___ yes X none reported

Type of auditor's report issued on compliance for major programs: Unmodified

Any audit findings disclosed that are required to be reported in accordance with Subpart F, Section 516 of the Uniform Guidance or Section 215.97, Florida Statutes and Chapter 10.650, Rules of the State of Florida Auditor General? ___ yes X no

Identification of major programs:

<u>Grantor/Program or Cluster Title</u>	<u>Federal CFDA or State Grant Number</u>
Federal:	
U.S. Department of Health and Human Services <i>Substance Abuse and Mental Health Services Administration</i> Comprehensive Community Mental Health Services for Children with Serious Emotional Disturbances (SED)	93.104
<i>Administration for Children and Families</i> Foster Care Title IV-E	93.658
State of Florida:	
<i>State of Florida, Department of Corrections</i> Substance Abuse Services	C2626/ C2658/ C2669

The dollar threshold used to distinguish between type A and type B programs was \$750,000 for both federal and State of Florida awards for the year ended June 30, 2016.

Auditee qualified as low-risk auditee? X yes ___ no

PHOENIX HOUSE FOUNDATION, INC. AND AFFILIATES
Schedule of Findings and Questioned Costs
For the year ended June 30, 2016

SECTION II - FINANCIAL STATEMENT FINDINGS

Finding 2016-001:

Phoenix Houses of Texas, Inc. – Disbursement Process – Material Weakness

Criteria:

Entities that are recipients of federal and state awards have a responsibility to design and implement an internal control environment to achieve effective and efficient operations; reliability of financial reporting; and, compliance with applicable laws and regulations. The control environment sets the tone of an organization, which influences the control consciousness of its people. The key factors impacting the control environment include, among other things, management’s philosophy and operating style, organizational structure, assignment of authority and responsibility and appropriate policies and practices.

Condition and Effect:

In response to our audit inquiries, PHF&A management informed the audit team of an alleged misappropriation of funds which occurred at the Phoenix Houses of Texas, Inc. (“PHTX”) affiliate, totaling approximately \$160,000, involving a member of PHTX’s finance function.

Context:

Following a review of PHTX’s disbursement practices, it was noted that PHTX’s Finance Director maintained the ability to unilaterally approve contracts and make check and wire disbursements without an independent supervisory level review occurring. In the aggregate, the irregular payments were deemed to be immaterial to PHF&A’s 2016 consolidated financial statements and PHTX’s standalone financial statements. In addition to the irregular disbursements that management identified, we also noted that several of PHTX’s bank accounts had not been reconciled for a period of up to six months prior to June 30, 2016. As a result of the identified, irregular disbursements and the absence of the timely preparation of bank account reconciliations, the engagement team evaluated these matters from an internal control perspective, and noted the deficiencies, when aggregated, constituted a material weakness in the internal control over financial reporting.

Questioned Costs:

The aggregation of the irregular payments discussed above, which appear to have been sent to a false vendor, totaled approximately \$160,000 and did not involve federal or State of Florida awards.

Recommendation:

As a result of the deficiencies identified above, we recommend that PHTX ensure that all bank accounts are reconciled on a monthly basis, following the end of each respective statement period, and that all disbursements and contract agreements be subjected to Phoenix House’s established levels of authority before occurring and being executed.

View of Responsible Officials and Planned Corrective Action:

Management agrees with the internal control finding discussed above. Management refers the reader to the separately provided Correction Action Plan for its remediation plan.

PHOENIX HOUSE FOUNDATION, INC. AND AFFILIATES
Schedule of Findings and Questioned Costs
For the year ended June 30, 2016

Finding 2016-002:

Phoenix Houses of Texas, Inc. – Recognition of Contributed Services – Significant Deficiency

Criteria

Entities that are recipients of federal and state awards have a responsibility to design and implement an internal control environment to achieve effective and efficient operations; reliability of financial reporting; and, compliance with applicable laws and regulations. The control environment sets the tone of an organization, which influences the control consciousness of its people. The key factors impacting the control environment include, among other things, management’s philosophy and operating style, organizational structure, assignment of authority and responsibility and appropriate policies and practices.

As a recipient of contributed services, on an annual basis, PHF&A is required to recognize such services at fair value in the year received in accordance with U.S. GAAP.

Condition and Effect:

During the closing process for the year ended June 30, 2016, due to a posting error, PHTX recognized \$410,417 rather than \$10,417 of contributed legal services. The cause of this error is believed to be the result of the absence of an independent review of the related journal entry and related supporting analysis. The effect of this error caused the initial (unaudited) amount of reported donated legal services revenues and related expenses to be overstated for the year.

Context:

Although the effect of this erroneous posting did not impact the overall change in net assets for 2016, the difference of \$400,000, between the actual amount of contributed services received and the recorded amount, caused unaudited 2016 revenues and expenses to be overstated in PHTX’s general ledger.

Questioned Costs:

None. Upon discovery of the related accounting error, appropriate journal entries were recorded by PHF&A to properly reflect the amount of contributed services received for the fiscal year.

Recommendation:

On a go-forward basis, we recommend that management ensure that an independent, supervisory level review of the contributed services analysis, calculation and related recognition be performed prior to posting such revenue and related expense to the general ledger to ensure accuracy.

View of Responsible Officials and Planned Corrective Action:

Management agrees with the internal control finding discussed above. Management refers the reader to the separately provided Correction Action Plan for its remediation plan.

SECTION III - FEDERAL AND STATE OF FLORIDA AWARD FINDINGS AND QUESTIONED COSTS

None noted.

PHOENIX HOUSE FOUNDATION, INC. AND AFFILIATES
Summary Schedule of Prior Year Findings and Questioned Costs
For the year ended June 30, 2016

Finding 2015-001:

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

Criteria, Condition, and Effect:

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 sign-off on check request forms by the respective project manager, prior to the actual disbursement occurring.

As it specifically pertains to the Phoenix Houses of New England, Inc. entity, for one of forty (40) 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.

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 identified by the Finance Department prior to final payment processing.

2016 Status Update:

PHF&A has updated its procedures to require that in 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
Rising Above Addiction

**“Corrective Action Plan”
“For the year ended June 30, 2016”**

Finding 2016-001:

Phoenix Houses of Texas, Inc. - Disbursement Process - Material Weakness

Condition and Effect:

In response to our audit inquiries, PHF&A management informed the audit team of an alleged misappropriation of funds which occurred at the Phoenix Houses of Texas, Inc. (“PHTX”) affiliate, totaling approximately \$160,000, involving a member of PHTX’s finance function.

View of Responsible Officials and Planned Corrective Action:

While we agree with the finding and recommendations, upon discovery of the irregularity in Texas and subsequent management investigation of the root causes, management conducted limited due diligence of procedures and controls in each of the other Phoenix House regions. Management concluded that the control weaknesses that led to these events in Texas were situationally unique, not pervasive across the entire organization, and that relevant controls are appropriate elsewhere. That said, the events in Texas have heightened management’s awareness of the need to be ever vigilant throughout all Phoenix House.

Name of Contact Person: Robert Wilson, Chief Financial Officer,
REWilson@phoenixhouse.org,
1-646-505-3954

Proposed Completion Date: The matters referred to in the above mentioned finding have been corrected.

Finding 2016-002:

Phoenix Houses of Texas, Inc. – Recognition of Contributed Services – Significant Deficiency

Condition and Effect:

During the closing process for the year ended June 30, 2016, due to a posting error, PHTX recognized \$410,417 rather than \$10,417 of contributed legal services. The cause of this error is believed to be the result of the absence of an independent review of the related journal entry and related supporting analysis. The effect of this error caused the initial (unaudited) amount of reported donated legal services revenues and related expenses to be over-stated for the year.

View of Responsible Officials and Planned Corrective Action:

Management agrees. We will strengthen existing procedures around the accumulation and recognition of contributed services.

Name of Contact Person: Robert Wilson, Chief Financial Officer,
REWilson@phoenixhouse.org,
1-646-505-3954

Proposed Completion Date: The matter referred to in the above mentioned finding has been corrected.
Finding 2015-001:

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

Criteria, Condition, and Effect:

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 sign-off on check request forms by the respective project manager, prior to the actual disbursement occurring.

As it specifically pertains to the Phoenix Houses of New England, Inc. entity, for one of forty (40) 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.

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 identified by the Finance Department prior to final payment processing.

2016 Status Update:

PHF&A has updated its procedures to require that in 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.