Consolidated Financial Statements and Florida Single Audit

The Devereux Foundation and Controlled Entities
d/b/a Devereux Advanced Behavioral Health
Year Ended June 30, 2018 and 2017
With Report of Independent Auditors

Ernst & Young LLP

Building a better working world

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d/b/a Devereux Advanced Behavioral Health

Consolidated Financial Statements
and Florida Single Audit

Years Ended June 30, 2018 and 2017

Contents

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Report of Independent Auditors

The Board of Trustees
The Devereux Foundation and Controlled Entities

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of The Devereux Foundation and Controlled Entities d/b/a Devereux Advanced Behavioral Health (Devereux), which comprise the consolidated balance sheets as of June 30, 2018 and 2017, 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 financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States 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 financial statements are free of material misstatement.

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

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

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Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of The Devereux Foundation and Controlled Entities d/b/a Devereux Advanced Behavioral Health as of June 30, 2018 and 2017, and the results of operations and changes in its net assets and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying schedule of expenditures of state financial assistance for Devereux for the year ended June 30, 2018 as required by Section 215.97, *Florida Statutes*, and Chapter 10.650, *Rules of the Auditor General*, is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the 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, including comparing and reconciling such 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. In our opinion, the 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 also have issued our report dated September 25, 2018, on our consideration of Devereux'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 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 Devereux's internal control over financial reporting and compliance.

Ernst & Young LLP

September 25, 2018, except for the schedule
of expenditures of state financial assistance,
for which the date is December 21, 2018

The Devereux Foundation and Controlled Entities
d/b/a Devereux Advanced Behavioral Health

Consolidated Balance Sheets

(In Thousands)

	June 30	
	2018	**2017**
Assets		
Current assets:		
Cash and cash equivalents, including client funds on deposits of $2,148 and $1,880 in 2018 and 2017, respectively	**$ 7,985**	$ 9,224
Accounts receivable, net of allowance for uncollectibles of $5,378 and $4,007 in 2018 and 2017, respectively	**54,960**	53,015
Current portion of assets limited as to use	**766**	798
Operating fund investments	**24,660**	17,030
Prepaid expenses and other current assets	**4,422**	4,502
Total current assets	**92,793**	84,569
Assets limited as to use:		
By board for designated purposes	**106,885**	117,896
By trustees under bond indenture agreements	**535**	536
By board for donor purposes	**15,924**	15,049
By insurance agreement	**8,000**	4,000
	131,344	137,481
Property and equipment, net	**109,429**	106,516
Other assets:		
Other assets	**1,508**	438
Pledges receivable and deferred gifts	**7,680**	6,745
Total other assets	**9,188**	7,183
Total assets	**$ 342,754**	$ 335,749

	June 30	
	2018	**2017**
Liabilities and net assets		
Current liabilities:		
Current portion of long-term debt	**$ 4,215**	$ 3,467
Accounts payable and accrued expenses	**10,276**	8,769
Employee compensation and related benefits	**26,747**	24,922
Current portion of estimated settlements due to third-party payors	**13,427**	15,193
Current portion of reserves under insurance programs and other current liabilities	**19,102**	13,499
Client funds on deposit	**2,148**	1,880
Total current liabilities	**75,915**	67,730
Estimated settlements due to third-party payors, net of current portion	**1,205**	1,786
Reserves under insurance programs and other liabilities, net of current portion	**19,011**	18,864
Deferred revenue	**6,062**	6,307
Obligation to provide future services and use of facilities to continuing care clients	**7,273**	6,323
Long-term debt, net of current portion	**45,046**	49,971
Total liabilities	**154,512**	150,981
Net assets:		
Unrestricted	**164,637**	162,711
Temporarily restricted	**16,694**	15,211
Permanently restricted	**6,888**	6,846
Total Devereux Advanced Behavioral Health net assets	**188,219**	184,768
Non-controlling interests	**23**	–
Total net assets including non-controlling interests	**188,242**	184,768
Total liabilities and net assets	**$ 342,754**	$ 335,749

See accompanying notes.

The Devereux Foundation and Controlled Entities
d/b/a Devereux Advanced Behavioral Health

Consolidated Statements of Operations and Changes in Net Assets

(In Thousands)

	Year Ended June 30	
	2018	**2017**
Unrestricted net assets		
Revenue:		
Net client revenue	**$ 458,421**	$ 437,322
Investment income	**9,961**	4,546
Gifts and bequests	**3,451**	6,811
Other revenue	**11,806**	10,078
Net assets released from restrictions for operations	**1,436**	1,831
	485,075	460,588
Expenses:		
Salaries and wages	**276,115**	264,975
Employee benefits	**82,433**	73,892
Food	**7,865**	7,641
Purchased services	**37,453**	34,940
Supplies	**7,836**	8,067
Plant operation and maintenance	**27,218**	25,884
Provision for bad debts	**2,546**	2,190
Depreciation and amortization	**14,385**	14,059
Interest	**2,491**	2,512
Insurance	**17,325**	8,342
Other	**11,104**	11,258
	486,771	453,760
Operating (loss) income before other items	**(1,696)**	6,828
Other items:		
Gain on early extinguishment of debt	**–**	34
Loss on investment in joint venture	**(368)**	(340)
Increase in obligation to provide future services and the use of facilities to continuing care clients	**(950)**	(239)
Change in fair value of interest rate swap	**305**	502
Net gain on disposition of property	**269**	223
Net gain on insurance proceeds from natural disaster	**2,664**	–
Other income	**1,920**	180
Excess of revenue over expenses before non-controlling interests	**224**	7,008
Less: Net loss attributable to non-controlling interests	**(17)**	–
Excess of revenue over expenses	**241**	7,008

(Continued on following page.)

The Devereux Foundation and Controlled Entities
d/b/a Devereux Advanced Behavioral Health

Consolidated Statements of Operations and Changes in Net Assets (continued)
(In Thousands)

	Year Ended June 30 2018	2017
Unrestricted net assets (continued)		
Excess of revenue over expenses	**$ 241**	$ 7,008
Other changes in unrestricted net assets:		
Unrealized gains on investments	**1,179**	10,467
Net assets released from restrictions for property and equipment purchases	**506**	467
Increase in unrestricted net assets	**1,926**	17,942
Temporarily restricted net assets		
Gifts, grants, and bequests, net	**3,496**	3,788
Net assets released from restrictions for operations	**(1,507)**	(1,942)
Net assets released from restrictions to finance property and equipment purchases	**(506)**	(467)
Increase in temporarily restricted net assets	**1,483**	1,379
Permanently restricted net assets		
Gifts, grants, and bequests	**3**	8
Net realized and unrealized gain on investments	**370**	459
Appropriations of net assets for intended purposes, net	**(331)**	(330)
Increase in permanently restricted net assets	**42**	137
Non-controlling interests		
Net loss attributable to non-controlling interests	**(17)**	–
Capital contributions	**40**	–
Increase in non-controlling interests	**23**	–
Increase in net assets, including non-controlling interests	**3,474**	19,458
Net assets, beginning of year	**184,768**	165,310
Net assets, end of year	**$ 188,242**	$ 184,768

See accompanying notes.

The Devereux Foundation and Controlled Entities
d/b/a Devereux Advanced Behavioral Health

Consolidated Statements of Cash Flows
(In Thousands)

	Year Ended June 30	
	2018	**2017**
Operating activities		
Increase in net assets, including non-controlling interests	**$ 3,474**	$ 19,458
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Net gain on disposition of property	**(269)**	(223)
Net gain on insurance proceeds from natural disaster	**(2,664)**	–
Depreciation and amortization	**14,385**	14,059
Provision for bad debts	**2,546**	2,190
Loss from joint venture	**368**	340
Net realized and unrealized gains in fair value of investments	**(3,827)**	(13,698)
Increase in obligation to provide future services	**950**	239
Change in fair value of interest rate swap	**(305)**	(502)
Restricted contributions	**(3,499)**	(3,796)
Changes in operating assets and liabilities:		
Accounts receivable	**(4,491)**	(4,152)
Prepaid expenses and other current assets	**80**	1,061
Pledges receivable	**71**	111
Accounts payable and accrued expenses	**1,497**	(1,772)
Employee compensation and related benefits	**1,825**	(5,547)
Deferred revenue	**(245)**	(561)
Estimated settlements due to third-party payors, net	**(2,347)**	(1,137)
Reserves under insurance programs and other current liabilities	**4,948**	1,187
Net cash provided by operating activities	**12,497**	7,257
Investing activities		
Purchases of property and equipment, net	**(16,946)**	(12,154)
Joint venture capital contributions	**(368)**	(389)
Net gain on insurance proceeds from natural disaster	**2,664**	–
Purchases of investments	**(23,579)**	(7,464)
Sales of investments	**25,945**	12,268
Net cash used in investing activities	**(12,284)**	(7,739)
Financing activities		
Proceeds from long-term debt	**–**	20,458
Repayments of long-term debt	**(3,945)**	(24,716)
Deferred financing costs incurred	**–**	(319)
Restricted contributions, net	**2,493**	3,047
Net cash used in financing activities	**(1,452)**	(1,530)
Decrease in cash and cash equivalents	**(1,239)**	(2,012)
Cash and cash equivalents at beginning of year	**9,224**	11,236
Cash and cash equivalents at end of year	**$ 7,985**	$ 9,224

See accompanying notes.

1. Organization and Basis of Presentation

The Devereux Foundation and Controlled Entities d/b/a Devereux Advanced Behavioral Health (Devereux) is a not-for-profit corporation, dually designated by the Internal Revenue Service (IRS) as an educational facility and health care organization, with a national network of behavioral health treatment centers for children, adolescents, and adults with complex emotional, psychiatric, and developmental disabilities, including individuals with autism spectrum disorders. Treatment settings range along a continuum from acute psychiatric inpatient and campus-based residential settings to community group homes, outpatient, foster care, in home, educational, vocational, and prevention programs.

Devereux functions as the sole corporate member for the following entities (the Controlled Entities), which are included in the accompanying consolidated financial statements:

> Helena Devereux Foundation (HD Foundation) is a Pennsylvania not-for-profit corporation, which holds certain assets to benefit Devereux's programs.
>
> Devereux Cleo Wallace (DCW) is a Colorado not-for-profit corporation that operates a psychiatric residential treatment facility and provides other behavioral health services in the Denver area. DCW is the sole corporate member of Devereux Cleo Wallace Foundation (DCW Foundation), a Colorado not-for-profit corporation that was established for the benefit of DCW.

Devereux holds a 60% interest in QualityHealth Staffing, LLC (QualityHealth), a consolidated subsidiary formed in February 2018 to provide behavioral health staffing services. The accounts of QualityHealth are consolidated with those of Devereux. The change in non-controlling interest is separately reported.

All significant intercompany balances and transactions have been eliminated in the accompanying consolidated financial statements.

1. Organization and Basis of Presentation (continued)

Devereux is affiliated with Devereux Community Based Care (DCBC), a Florida not-for-profit corporation which administers and coordinates child welfare and related services in Indian River, Martin, Okeechobee, and St. Lucie counties in Florida. Devereux provides certain administrative, financial, and other support services to DCBC. Through June 30, 2018, it also appointed a simple majority of DCBC's Board of Directors, with the remaining seats filled by individuals from the local community. However, major decisions of the board require supermajority approval, defined as two-thirds of the directors. Accordingly, Devereux did not control the board of DCBC and, because it also has no direct economic or controlling interest, DCBC is not consolidated into Devereux's consolidated financial statements. Effective July 1, 2018, DCBC changed its name to Communities Connected for Kids, Inc. (CCK). Devereux continues to provide administrative services to CCK, but it no longer appoints any members to CCK's Board.

2. Summary of Significant Accounting Policies

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States (U.S. GAAP) requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents, for which the carrying value approximates fair value, include money market funds and certain investments with original maturities of three months or less.

Fair Value of Financial Instruments

Financial instruments consist of cash equivalents, accounts receivable, assets limited as to use and operating fund investments, accounts payable and accrued expenses, and long-term debt. The carrying amounts reported on the consolidated balance sheets for cash equivalents, accounts receivable, and accounts payable and accrued expenses approximate fair value. Management's estimates of the fair value of other financial instruments are described elsewhere in the notes to the consolidated financial statements.

2. Summary of Significant Accounting Policies (continued)

Allowance for Uncollectibles

Devereux provides an allowance for uncollectible accounts for estimated losses resulting from the unwillingness or inability of clients to make payments for services. The allowance is determined by analyzing specific accounts and historical data and trends. Accounts receivable are charged off against the allowance for uncollectible accounts when management determines that recovery is unlikely and Devereux ceases collection efforts.

Assets Limited as to Use, Investments, and Investment Income

Assets limited as to use include assets set aside by the Board of Trustees (the Board), assets held by trustees under bond indenture agreements, assets for insurance agreements, and assets held by the Board for donor purposes. Amounts set aside by the Board are designated for the operation of certain facilities, scholarships, continuing care, and other contingencies. The Board retains control over designated assets and may, at its discretion, subsequently use the assets for other purposes. Assets limited as to use that are required for current obligations or designated for current use are reported as current assets.

Investments in debt and equity securities are measured at fair value based on quoted market prices. Investment income or loss (including realized gains and losses on investments, interest, and dividends) is included in unrestricted investment income, or included in restricted investment income, if such income is restricted by the donor or legislation. Devereux periodically reviews its investments for other-than-temporary declines in the market value of investments. When an other-than-temporary decline is identified, the investment's cost is written down to the current market value, and the loss is recorded as a component of the excess of revenue over expenses.

Assets limited as to use and operating fund investments are classified as other-than-trading securities. Unrealized gains and losses on investments, to the extent that such losses are considered temporary, are reported as a component of other changes in unrestricted net assets or restricted net assets. Realized gains and losses on investments sold are computed using the weighted average cost method.

2. Summary of Significant Accounting Policies (continued)

Property and Equipment

Property and equipment are recorded at cost or, if donated, at fair market value at the date of receipt. Depreciation is provided on a straight-line basis over the expected useful lives of the assets. Gifts of long-lived assets, such as land, buildings, or equipment, are reported as other changes in net assets. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of acquiring those assets. No interest was capitalized in 2018 or 2017.

Deferred Financing Costs

Deferred financing costs represent expenditures incurred in the issuance of long-term debt, and are amortized using the effective-interest-rate method over the term of the related debt. These costs are presented on the consolidated balance sheet as a direct reduction of the carrying value of the associated debt, consistent with the presentation of debt discounts or premiums.

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets represent those assets whose use has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by Devereux in perpetuity, with income generally available to support health care and education services.

Permanently restricted net assets are invested on a pooled basis with Devereux's Board-designated investments. In accordance with Commonwealth of Pennsylvania Act 141, organizations are annually permitted to spend between 2% and 7% of permanently restricted net assets. For both 2018 and 2017, Devereux elected to spend at a rate of 4.5%. Additionally, in accordance with the Pennsylvania law, Devereux classifies as permanently restricted net assets (a) the value of gifts donated to the permanent endowment and (b) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument. This is regarded as the "historic dollar value" of the endowed fund. Any remaining unspent earnings or net appreciation of the donor-restricted endowment funds is not classified in permanently restricted net assets and is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by Devereux in a manner consistent with Devereux's spending policy.

2. Summary of Significant Accounting Policies (continued)

Excess of Revenue Over Expenses

Included in the excess of revenue over expenses on the accompanying consolidated statements of operations and changes in net assets are all changes in unrestricted net assets, except for unrealized gains and losses on investments, to the extent that such losses are considered temporary, and net assets released from restrictions for property and equipment purchases.

For purposes of presentation, transactions deemed by management to be ongoing, major, or central to the provision of services are reported as operating revenue and operating expenses; peripheral or incidental transaction and unusual, nonrecurring items are not included in operating results and are reported as other items within excess of revenues over expenses.

Income Taxes

The IRS determined that Devereux, HD Foundation, DCW, and DCW Foundation qualify for exemption from federal income taxes under the Internal Revenue Code. Accordingly, no provision for federal or state income taxes is included in the accompanying consolidated financial statements. Devereux, HD Foundation, DCW, and DCW Foundation have reviewed the technical merits of each of its tax positions in accordance with U.S. GAAP for uncertainty in income taxes, and have determined there are no uncertain tax positions that would have a material impact on the accompanying consolidated financial statements. The profits and losses of QualityHealth passthrough to Devereux based on their member share. Provisions for income taxes related to this income is not material to the consolidated financial statements.

The Tax Cuts and Jobs Act (Act) was enacted on December 22, 2017. For tax-exempt entities, the Act requires organizations to categorize certain fringe benefit expenses as a source of unrelated business income, pay an excise tax on remuneration above certain thresholds that is paid to executives by the organization, and report income or loss from unrelated business activities on an activity-by-activity basis, among other provisions. Certain regulatory guidance provides for a measurement period of up to one year during which the accounting for the tax effects of the Act may be completed. Devereux will continue to revise and refine the calculations as additional IRS guidance is issued. Devereux may record adjustments in future periods upon obtaining, preparing, or analyzing additional information about facts and circumstances that existed as of the date of enactment that would have affected the income tax effects. At June 30, 2018, Devereux has made

2. Summary of Significant Accounting Policies (continued)

a reasonable estimate of the tax effects of the enactment of the Act and does not anticipate the Act to have a material impact on the consolidated financial statements.

Charity Care

In advancement of its charitable mission, Devereux accepts clients with limited or no ability to pay for services. A client is classified as a charity client by reference to certain established policies. Essentially, these policies define charity services as those for which payment is not anticipated. In assessing a client's ability to pay, Devereux uses generally recognized poverty income levels, but also includes cases where incurred charges are significant relative to income.

Under certain governmental reimbursement programs, Devereux has been paid an amount less than actual costs due to agency budgetary constraints or other factors. The economic loss attributable to such programs is also included as charity care. Charity care amounts are not included in net client revenue or accounts receivable. The amount of costs incurred for services provided to clients that qualify for charity care and the economic shortfall attributable to unreimbursed costs of certain programs aggregated $18,389 and $11,664 in 2018 and 2017, respectively.

Devereux also provides a variety of services and benefits within the communities in which it operates, for which no compensation is received. The cost of these services has not been quantified and, therefore, is not included in the charity care amounts referred to above.

Contributions and Pledges Receivable

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. Unconditional promises to give cash and other assets that are expected to be collected in future years are recorded at the present value of estimated future cash flows. The discounts on those amounts are computed using a risk-free interest rate applicable to the year in which the promise is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the timing or nature in which donated assets can be used. When a donor restriction expires, temporarily restricted net assets are reclassified as unrestricted net assets and reported on the consolidated statement of operations and changes in net assets as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as gifts and bequests in the accompanying consolidated financial statements.

2. Summary of Significant Accounting Policies (continued)

Functional Expenses

Devereux and its members' primary mission is to provide behavioral health care, education, and child welfare services to its clients. The majority of all operating expenses incurred were related to the provision of these services.

Reclassifications

Certain reclassifications have been made to the consolidated financial statements of the prior year to conform to the current year presentation. These reclassifications had no impact on previously reported net assets.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers (Topic 606)*. The new standard will require revenue recognized to represent the transfer of promised goods or services to customers in an amount that reflects the consideration in which a company expects to receive in exchange for those goods or services. The standard also requires new, expanded disclosures regarding revenue recognition. The guidance in ASU 2014-09 supersedes the FASB's current revenue recognition requirements and most industry-specific guidance. The FASB subsequently issued ASU 2015-14, *Revenue from Contracts with Customers (Topic 606)*, which deferred the effective dates of ASU 2014-09. Based on ASU 2015-14, the provisions of ASU 2014-09 become effective for Devereux for annual reporting periods beginning after December 15, 2017, and interim periods within that reporting period. Devereux will adopt ASU 2014-09 following the modified retrospective method with a cumulative effect adjustment recognized at the date of the initial application in net assets. The adoption could impact the recognition and disclosure of revenue, including judgments regarding collection analyses and estimates of variable consideration, and the addition of certain qualitative and quantitative disclosures. Devereux continues to complete its assessments of the potential impact of the adoption of this guidance, which includes a review of a representative sample of contracts, discussions with key stakeholders, calculating the transition adjustment, as applicable, and finalizing new accounting policies, and financial controls. Devereux currently does not anticipate a material impact on the revenue recognition practices for net client revenue.

2. Summary of Significant Accounting Policies (continued)

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. ASU 2016-01 will require business-oriented health care not-for-profit entities to measure equity investments that do not result in consolidation and are not accounted for under the equity method at fair value and recognize any changes in fair value in the performance indicator unless the investments qualify for a new practicality exception. The practicality exception is available for equity investments without a readily determinable fair value, for which measurement would be based on cost less impairment and adjusted for observable price changes. This standard also allows entities that are not public business entities, among other things, to no longer disclose the fair value and significant assumptions used to estimate the fair value of certain financial instruments carried at amortized cost. The guidance is effective for annual periods beginning after December 15, 2018. Devereux early adopted the provision of the standard that eliminates the disclosure requirement for the fair value of long-term debt. Subsequent to the adoption of the remaining provisions of ASU 2016-01 that are not eligible for early adoption, Devereux will no longer be able to recognize unrealized holding gains and losses on equity securities currently classified as other-than-trading outside of the performance indicator. This ASU does not impact the accounting for investments in debt securities.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*, which will require a lessee to report most leases on its balance sheet but recognize expenses on its income statement in a manner similar to current accounting. The guidance also eliminates current real estate-specific provisions. The provisions of ASU 2016-02 are effective for Devereux for annual periods beginning after December 15, 2018, and interim periods within those years. Early adoption is permitted. Devereux is currently evaluating the impact the adoption of this standard will have on the consolidated financial statements.

In August 2016, the FASB issued ASU 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*, which simplifies and improves how a not-for-profit organization classifies its net assets, as well as the information it presents in financial statements and notes about its liquidity, financial performance, and cash flows. The guidance is effective for fiscal years beginning after December 15, 2017, and interim periods within fiscal years beginning after December 15, 2018. Early application is permitted. The guidance must be initially adopted for an annual fiscal period or for the first interim period within the fiscal year of adoption. The guidance will be applied retrospectively. Devereux is currently evaluating the impact the adoption of this standard will have on the consolidated financial statements.

2. Summary of Significant Accounting Policies (continued)

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows – Classification of Certain Cash Receipts and Cash Payments,* which addresses the following eight specific cash flow issues in order to limit diversity in practice: debt prepayment or debt extinguishment costs; settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies; distributions received from equity method investees; beneficial interests in securitization transactions; and separately identifiable cash flows and application of the predominance principle. The provisions of ASU 2016-15 are effective for Devereux for annual periods beginning after December 15, 2018, and interim periods thereafter. Early adoption is permitted. Devereux has not completed the process of evaluating the impact of ASU 2016-15 on its consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows – Restricted Cash*, which requires that the statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The provisions of ASU 2016-18 are effective for Devereux for annual periods beginning after December 15, 2018, and interim periods thereafter. Early adoption is permitted. Devereux has not completed the process of evaluating the impact of ASU 2016-18 on its consolidated financial statements.

Subsequent Events

In accordance with Accounting Standards Codification (ASC) 855, *Subsequent Events*, management has evaluated subsequent events through the date the accompanying consolidated financial statements were issued on September 25, 2018.

3. Net Client Revenue

Accounts receivable and net client revenue are reported on the accrual basis in the period in which services are rendered at established rates, net of contractual adjustments, discounts, and charity care. Devereux recognizes bad debt expense and the allowance for uncollectible accounts based on its historical experience and individual account analysis.

The majority of services are rendered to clients through reimbursement programs administered by state and local governmental agencies, in some cases through a contracted managed care organization. No single government agency accounted for more than 10% of revenue in 2018 or 2017. Under these programs, reimbursed amounts are based upon fee-for-service rates, a combination of historical costs and prospectively determined rates, or reasonable costs, as defined. In total, these programs accounted for 95% and 94% of total net client revenue in fiscal years 2018 and 2017, respectively. Remaining services are rendered through payment arrangements with managed care organizations, commercial insurance carriers, or private accounts.

Certain governmental agencies pay an interim rate or a fixed periodic amount during the period Devereux provides services and retroactively adjusts the reimbursement based upon actual costs incurred during the year or based on actual units of service delivered. Third-party settlements with governmental agencies are accrued on an estimated basis in the period the related services are rendered. Estimated settlements due to third-party payors are classified as current or noncurrent based on the anticipated timing of settlements. Differences between the estimated settlement and the finalized amounts are recorded in the year of settlement. During 2018 and 2017, prior year settlement adjustments increased net client revenue by $2,416 and $2,620, respectively. In the opinion of management, adequate provision has been made for any additional adjustments that may result from the final settlement of outstanding cost reports.

Devereux is subject to numerous laws and regulations of federal, state, and local governments. Compliance with these laws and regulations can be subject to government review and interpretation, as well as regulatory actions unknown and unasserted at this time. Government activity in the health care industry continues to increase with respect to investigations and allegations concerning possible violations of regulations by health care providers, which could result in the imposition of significant fines and penalties, as well as significant repayments of previously billed and collected revenues of client services. Devereux has implemented a corporate compliance program and conducts documentation audits of services provided and the underlying clinical documentation to ensure compliance with established regulations. When potential overpayments are identified, payors are notified and refunds are issued.

(In Thousands)

4. Investments

Investments are stated at fair value as follows:

	June 30	
	2018	**2017**
Assets limited as to use and operating fund investments:		
Cash and cash equivalents	**$ 3,474**	$ 4,123
Equity mutual funds	**64,774**	57,093
Commodity funds	**8,414**	7,813
Real estate investment trust (REIT) funds	**4,604**	4,027
Fixed-income mutual funds	**7,710**	1,695
Multi-asset funds	**57,220**	70,104
U.S. government and agency bonds	**10,574**	10,454
Total	**$ 156,770**	$ 155,309

Investment income and realized and unrealized gains and losses on investments and cash and cash equivalents are composed of the following:

	Year Ended June 30	
	2018	**2017**
Unrestricted net assets		
Amounts included in investment income:		
Interest, dividends, and distributions	**$ 7,683**	$ 1,774
Net realized gains on sales of investments	**2,278**	2,772
	9,961	4,546
Other changes in unrestricted net assets:		
Net change in unrealized gains on investments	**1,179**	10,467
Permanently restricted net assets		
Net realized and unrealized gains on investments	**370**	459
Total investment gain	**$ 11,510**	$ 15,472

(In Thousands)

4. Investments (continued)

Devereux's gross unrealized losses and fair value of individual securities, aggregated by investment category, which have been in a continuous unrealized loss position less than 12 months and greater than 12 months are as follows:

	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
June 30, 2018						
Commodity funds (1 security)	**$ –**	**$ –**	**$ 8,414**	**$ (289)**	**$ 8,414**	**$ (289)**
Fixed-income mutual funds (2 securities)	**89**	**(2)**	**7,220**	**(265)**	**7,309**	**(267)**
U.S. government and agency bonds (8 securities)	**571**	**(12)**	**3,616**	**(41)**	**4,187**	**(53)**
Multi-asset fund (1 security)	**40,165**	**(1,058)**	**–**	**–**	**40,165**	**(1,058)**
Total	**$ 40,825**	**$ (1,072)**	**$ 19,250**	**$ (595)**	**$ 60,075**	**$ (1,667)**
June 30, 2017						
Commodity funds (1 security)	$ –	$ –	$ 7,813	$ (1,342)	$ 7,813	$ (1,342)
Fixed-income mutual funds (1 security)	1,202	(11)	–	–	1,202	(11)
U.S. government and agency bonds (10 securities)	3,882	(36)	765	(20)	4,647	(56)
Total	$ 5,084	$ (47)	$ 8,578	$ (1,362)	$ 13,662	$ (1,409)

At June 30, 2018 and 2017, management determined that the unrealized losses were temporary based on the extent and length of time the securities' fair value was below cost, and are not material to the overall investment portfolio.

Additionally, as of June 30, 2018 and 2017, Devereux had gross unrealized gains of $23,484 and $22,109 on investments with fair values of $96,695 and $141,647, respectively.

(In Thousands)

5. Fair Value Measurements

In determining fair value, Devereux uses the market approach. The market approach utilizes prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities. Information used to establish fair value estimates falls into three tiers, which prioritize the inputs used in measuring fair value. These tiers include Level 1 – defined as observable inputs such as quoted prices in active markets; Level 2 – defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3 – defined as unobservable inputs in which little or no market data exists, therefore, requiring an entity to develop its own assumptions.

The following tables present the fair value hierarchy for Devereux's financial assets and liabilities measured at fair value on a recurring basis.

	Total	Level 1	Level 2	Level 3
June 30, 2018				
Cash and cash equivalents	**$ 7,985**	**$ 7,985**	**$ –**	**$ –**
Assets limited as to use and operating fund investments:				
Cash and cash equivalents	**$ 3,474**	**$ 3,474**	**$ –**	**$ –**
Equity mutual funds	**64,774**	**64,774**	**–**	**–**
Commodity funds	**8,414**	**8,414**	**–**	**–**
REIT funds	**4,604**	**4,604**	**–**	**–**
Fixed-income mutual funds	**7,710**	**7,710**	**–**	**–**
Multi-asset funds	**17,055**	**17,055**	**–**	**–**
U.S. government and agency bonds	**10,574**	**–**	**10,574**	**–**
	116,605	**$ 106,031**	**$ 10,574**	**$ –**
Multi-asset fund measured at net asset value	**40,165**			
Total assets limited as to used and operating fund investments at fair value	**$ 156,770**			
Beneficial interest in trusts held by third parties, net *(Note 7)*	**$ 7,242**	**$ –**	**$ –**	**$ 7,424**
Liabilities:				
Interest rate swap	**$ 42**	**$ –**	**$ 42**	**$ –**

(In Thousands)

5. Fair Value Measurements (continued)

	Total	Level 1	Level 2	Level 3
June 30, 2017				
Cash and cash equivalents	$ 9,224	$ 9,224	$ –	$ –
Assets limited as to use and operating fund investments:				
Cash and cash equivalents	$ 4,123	$ 4,123	$ –	$ –
Equity mutual funds	57,093	57,093	–	–
Commodity funds	7,813	7,813	–	–
REIT funds	4,027	4,027	–	–
Fixed-income mutual funds	1,695	1,695	–	–
Multi-asset funds	27,125	27,125	–	–
U.S. government and agency bonds	10,454	–	10,454	–
	112,330	$ 101,876	$ 10,454	$ –
Multi-asset fund measured at net asset value	42,979			
Total assets limited as to used and operating fund investments at fair value	$ 155,309			
Beneficial interest in trusts held by third parties, net *(Note 7)*	$ 6,456	$ –	$ –	$ 6,456
Liabilities:				
Interest rate swap	$ 347	$ –	$ 347	$ –

(In Thousands)

5. Fair Value Measurements (continued)

The following table sets forth the change in the fair value of financial instruments using significant unobservable inputs:

Fair value balance, June 30, 2016	$ 5,857
Additions	194
Distributions	–
Changes in fair value	405
Fair value balance, June 30, 2017	6,456
Additions	**625**
Distributions	**–**
Changes in fair value	**343**
Fair value balance, June 30, 2018	**$ 7,424**

Devereux's Level 1 securities primarily consist of cash, money market funds, equity mutual funds, commodity funds, REIT funds, fixed-income mutual funds, and multi-asset funds. Devereux determines the estimated fair value for its Level 1 securities using quoted (unadjusted) prices for identical assets or liabilities in active markets. Devereux's Level 2 securities primary consist of U.S. government and agency bonds. Devereux determines the estimated fair value for its Level 2 securities using quoted prices for similar assets or liabilities in active markets.

In accordance with ASC Subtopic 820-10, the multi-asset fund that is measured at fair value using the net asset value per share (or its equivalent) practical expedient has not been classified in the fair value hierarchy. The fair value amounts presented in the tables are to permit reconciliation of the fair value hierarchy to the amounts presented on the consolidated balance sheets.

The estimated value of the beneficial interest in trusts held by third parties is determined based on information provided by the trustee, including Devereux's proportional interest in the net assets of the trust. The assets held in trust consist primarily of cash equivalents and marketable securities. The fair value of the interest of trusts held by third parties is measured using the underlying value of the investments, as well as discounted cash flow analysis of the expected cash flow of the trusts, and is reported as Level 3.

(In Thousands)

5. Fair Value Measurements (continued)

The interest rate swap, which is classified as a Level 2 liability, is valued using techniques, including discounted cash flow analysis on the expected cash flow of the derivative. This analysis reflects the contractual terms of the derivative, including the period to maturity, and uses observable market-based inputs, including interest rate curves.

6. Property and Equipment

	Estimated Useful Lives	June 30 2018	2017
Land		**$ 6,573**	$ 6,575
Land improvements	8–25 years	**26,352**	25,416
Buildings and improvements	5–40 years	**240,863**	232,308
Equipment	3–20 years	**64,905**	64,418
		338,693	328,717
Less accumulated depreciation		**232,983**	225,510
		105,710	103,207
Construction-in-progress		**3,719**	3,309
		$ 109,429	$ 106,516

Depreciation expense was $14,302 and $13,974 in 2018 and 2017, respectively.

In 2017, Devereux wrote off approximately $11,500 of fully depreciated assets, much of which consisted of information technology equipment no longer in use.

(In Thousands)

7. Pledges Receivable and Deferred Gifts

The following is a summary of promises to give funds to Devereux:

	June 30	
	2018	**2017**
Pledges receivable in:		
Less than one year	**$ 51**	$ 68
One to five years	**237**	265
	288	333
Less allowance for uncollectible accounts	**(13)**	(18)
Less discount to present value	**(19)**	(26)
Pledges receivable, net	**256**	289
Beneficial interest in trusts held by third parties, net	**7,424**	6,456
Total	**$ 7,680**	$ 6,745

The present value of the future cash flows of pledges receivable was determined using discount rates approximating 2.0% for 2018 and 2017.

Devereux periodically receives indications of an intention to give from individuals through the settlement of the individuals' estates. The anticipated value of these intended gifts has not been established, nor has it been recognized as an asset on the consolidated balance sheets.

The beneficial interests in trusts are unconditionally designated for the benefit of Devereux upon the occurrence of some future event. The interests are recorded at fair value as represented by the third-party trustee.

(In Thousands)

8. Long-Term Debt

	June 30 2018	June 30 2017
$18,225 tax-exempt Chester County Health and Education Facilities Authority Revenue Bonds, Series of 2016 (the 2016 Pennsylvania Bonds)	**$ 17,210**	$ 18,225
3.25% to 7.15% mortgages payable monthly through October 2028, secured by the related properties, equipment, or revenue	**6,877**	7,473
$6,580 tax-exempt Chester County Health and Education Facilities Authority Revenue Bonds, Series of 2011 (the 2011 Pennsylvania Bonds)	**3,876**	4,277
$8,745 tax-exempt Chester County Health and Education Facilities Authority Revenue Bonds, Series of 2012 (the 2012 Pennsylvania Bonds)	**6,137**	6,682
$7,054 tax-exempt Colorado Health Facilities Authority Revenue Bonds, Series of 2012 (the 2012 Colorado Bonds)	**3,438**	4,225
$9,000 taxable borrowing from a bank (the 2013 Loan)	**6,241**	6,714
$5,000 taxable borrowing from a bank (the 2015 Loan)	**4,596**	4,724
Total long-term debt	**48,375**	52,320
Less current portion	**(4,215)**	(3,467)
Less deferred financing costs	**(792)**	(875)
Net original issue premium	**1,678**	1,993
Net long-term debt	**$ 45,046**	$ 49,971

In October 2016, Devereux issued the 2016 Pennsylvania Bonds to refinance previously issued bonds, resulting in a gain of $34 on the early retirement. The 2016 Pennsylvania Bonds were sold at an original issue premium of $2,233, which resulted in an effective interest rate of 2.74% over the life of the bonds. The 2016 Pennsylvania bonds mature over a 15-year period.

8. Long-Term Debt (continued)

In February 2015, Devereux entered into an agreement with a bank to borrow $5,000 in fixed-rate debt (the 2015 Loan) to finance certain capital expenditures. The 2015 Loan matures over a 25-year period, and the bank has the option to put the loan to Devereux after 10 years (February 12, 2025). The interest rate is currently fixed at 4.214% for ten years, after which it will reset at the then current rate.

In July 2013, Devereux entered into an agreement with a bank to borrow $9,000 in variable-rate debt (the 2013 Loan) that was used to currently refund previously issued bonds and finance certain capital expenditures. The 2013 Loan, as amended, matures over a 15-year period; however, on July 1, 2025, the bank has the option to put the loan to Devereux. Concurrent with the 2013 Loan, Devereux entered into a 15-year interest rate swap with an original notional amount of $8,393 (current notional amount of $6,714) that effectively fixes the interest rate at 5.028%.

The 2012 Pennsylvania and 2012 Colorado Bonds were issued to refinance previously issued tax-exempt debt. All of the bonds were acquired by a financial institution. The bonds mature over a 15-year period, and the financial institution has an option to put the bonds after 7 years (original date of November 1, 2019). However, at certain advance dates, Devereux can request one-year extensions to the call option date. As a result of approved extensions, the current put option date is November 1, 2020. The 2012 Pennsylvania and 2012 Colorado Bonds bear interest at a fixed rate, subject to a rate reset after 7 years and 12 years if the bonds are not called by the financial institution.

The 2011 Pennsylvania Bonds were issued to refinance previously issued tax-exempt debt. All of the bonds were acquired by a financial institution. The 2011 Pennsylvania Bonds bear interest at a variable rate equal to 65.00% of the one-month London Interbank Offered Rate (LIBOR), plus a margin of 1.40%. The rate on the bonds at June 30, 2018, was 2.759%. The bonds mature over a 15½-year period, and the financial institution has an option to put the bonds after 7 years (original date of December 15, 2018) However, at certain advance dates, Devereux can request one-year extensions to the call option date. As a result of approved extensions, the current put option date is December 15, 2021.

(In Thousands)

8. Long-Term Debt (continued)

All of the tax-exempt bonds and the 2013 and 2015 Loans were issued under a Master Trust Indenture (MTI) for which Devereux, HD Foundation, DCW, and DCW Foundation represent the obligated group and were issued to advance, refund, or refinance previously issued tax-exempt bonds and other debt; to finance certain capital expenditures; and to fund required debt service and reserve funds. They are secured by an interest in gross revenues, as defined, as well as mortgages on certain properties.

Original issue premiums or discounts on bonds are amortized using the interest method over the term of the related debt.

Agreements related to the Revolving Credit Agreement (see Note 9) and the debt issued under the MTI, contain financial covenants requiring Devereux to maintain debt service coverage and liquidity ratios. All such covenants were complied with as of and for the years ended June 30, 2018 and 2017.

Other information relating to each of the bonds, all of which have serial and term components, is as follows:

	2016 Pennsylvania Bonds	**2015 Loan**	**2013 Loan**
Scheduled principal payments	November 1	Monthly	July 1
Year of final maturity	2031	2040	2028
Range of principal and/or sinking fund payments	\$100 to \$1,735	\$132 to \$308	\$497 to \$769
Interest payment dates	May 1 and November 1	Monthly	Monthly
Range of coupon interest rates	1.00% to 5.00%	4.214%	5.028%

(In Thousands)

8. Long-Term Debt (continued)

	2012 Pennsylvania Bonds	**2012 Colorado Bonds**	**2011 Pennsylvania Bonds**
Scheduled principal payments	November 1	November 1	May 1 and November 1
Year of final maturity	2028	2028	2027
Range of principal and/or sinking fund payments	\$556 to \$674	\$167 to \$727	\$409 to \$454
Interest payment dates	May 1 and November 1	May 1 and November 1	May 1 and November 1
Range of coupon interest rates	2.15%	2.28%	Variable

Scheduled maturities of all long-term debt for the next five years and thereafter ending June 30 are as follows:

2019	$ 4,215
2020	4,071
2021	3,644
2022	3,798
2023	4,420
Thereafter	28,227

Interest paid on all indebtedness amounted to $2,510 and $2,584 in 2018 and 2017, respectively.

9. Note Payable

Devereux has a bank Revolving Credit Agreement (Revolver) with a maximum borrowing limit of $39,300, which is available for working capital and letters of credit. The Revolver expires November 30, 2018, although management expects to extend the Revolver for an additional one-year term. The Revolver is secured by a parity lien on gross revenues and by mortgages on certain Devereux properties, as defined under the MTI (see Note 8). Interest on working capital loans accrues at the one-month LIBOR plus an applicable margin of 1.00%. At June 30, 2018 and 2017, no working capital loans were outstanding. At June 30, 2018, letters of credit aggregating $11,075 were used to secure deductibles under insurance policies (see Note 14). Fees on outstanding letters of credit accrue at 1.00% at June 30, 2018 and 2017. A commitment fee of 0.25% is paid on unused Revolver amounts.

10. Obligation to Provide Future Services and the Use of Facilities to Continuing Care Clients

Devereux is contractually obligated to provide care for life to certain clients. The obligation, which recognizes the future costs to be incurred under these continuing care contracts, was computed using the following assumptions for 2018 and 2017: annual cost of care based on actual operating costs, life expectancy, an inflation factor of 4.75% of the average annual operating cost, an interest yield of 6.00%, and a reduction for any supplemental payments, including social security which is assumed to increase 3.00% annually, received on behalf of the clients.

As of June 30, 2018, there were 16 individuals covered by continuing care contracts.

Devereux also recognizes the present value of certain arrangements with several continuing care residents under which Devereux is the beneficiary of the assets of trusts established on behalf of the residents.

(In Thousands)

10. Obligation to Provide Future Services and the Use of Facilities to Continuing Care Clients (continued)

The present value of the components of the obligation follows:

	June 30	
	2018	**2017**
Gross liability	**$ 15,703**	$ 16,394
Social Security and other benefits	**(7,626)**	(7,649)
Future trust interests	**(804)**	(2,422)
	$ 7,273	$ 6,323

11. Retirement Plan

Devereux has a defined contribution retirement plan covering all eligible employees, administered by the Teachers Insurance and Annuity Association (TIAA). To be eligible for an employer contribution, an employee must have completed two years of service, work a minimum of 1,000 hours annually, and be actively employed at the end of the plan year (December 31). Employer contributions to the plan are generally based on 5% of the employee's compensation, plus a match of employee contributions up to 2% of compensation, and are made annually each January. These contributions are credited to individual annuity contracts owned by each participant and are charged to expense when earned. Contribution expense was $8,729 and $8,226 in 2018 and 2017, respectively.

(In Thousands)

12. Temporarily Restricted Net Assets

Temporarily restricted net assets are available for the following purposes:

	June 30 2018	June 30 2017
Purchase of property and equipment	**$ 771**	$ 454
Behavioral health care and education services	**4,585**	4,365
Research	**1,313**	1,069
Other	**2,432**	2,595
For future periods	**7,593**	6,728
	$ 16,694	$ 15,211

During 2018 and 2017, $1,507 and $1,942, respectively, of temporarily restricted net assets were released from restrictions for operations, of which $71 and $111, respectively, related to the collection of previous pledges. These amounts are classified as a component of unrestricted gifts and bequests on the consolidated statements of operations and changes in net assets.

13. Permanently Restricted Net Assets

Activity in Devereux's permanently restricted net assets is as follows:

	June 30 2018	June 30 2017
Endowment balance at beginning of year	**$ 6,846**	$ 6,709
Investment income return:		
Investment income	**100**	95
Realized and unrealized losses	**370**	459
Total investment income return	**470**	554
Contributions	**3**	8
Appropriation of endowment assets for intended purpose	**(431)**	(425)
Endowment balance at end of year	**$ 6,888**	$ 6,846

(In Thousands)

14. Commitments and Contingencies

Operating Leases

Devereux leases various equipment and facilities under operating leases expiring at various dates through 2024. Total rent expense for the years ended June 30, 2018 and 2017, was $9,253 and $9,145, respectively. The following is a schedule by year of future minimum lease payments under operating leases as of June 30, 2018, that have initial or remaining lease terms in excess of one year.

Year ending June 30:	
2019	$ 7,028
2020	5,210
2021	4,080
2022	2,618
2023	1,867
Thereafter	4,254
	$ 25,057

Workers' Compensation

Devereux maintained workers' compensation insurance with a per-claim deductible of $750 for 2018 and 2017. Due to this level of retention, Devereux maintains $1,009 of cash on deposit with its insurers for the payment of future claims, which is included in operating fund investments on the consolidated balance sheets. Additionally, Devereux is required to post letters of credit of $11,075 as collateral for its obligations as of June 30, 2018 and 2017 (see Note 9). Based upon historical loss experience, management determined that a $11,883 and $12,711 liability for the estimated retention and costs of claims not settled as of June 30, 2018 and 2017, respectively, be recorded as a component of reserves under insurance programs and other liabilities on the consolidated balance sheets.

14. Commitments and Contingencies (continued)

Professional and General Liability

Devereux is insured under a claims-made policy for professional liability and an occurrence policy for general liability. Devereux retained $8,000 for 2018 and 2017 in aggregate deductibles ($4,000 for any individual claims) related to the combination of professional and general liability coverage. Due to this level of retention, Devereux is required to post $8,000 of collateral, which was met with an insurance trust holding U.S. government and agency bonds valued at $8,861 as of June 30, 2018. Based upon historical loss experience, management determined that a $17,200 and $10,283 liability for the estimated retention and cost of claims and incidents not settled as of June 30, 2018 and 2017, respectively, be recorded as a component of reserves under insurance programs and other liabilities on the consolidated balance sheets. Devereux plans to continue to obtain adequate professional and general liability insurance. For the year ended June 30, 2018, Devereux recorded expense of $10,200 related to past policy years as a change in estimate based on updated actuarial analysis and settlement activity. This charge incorporated several cases either settled in 2018 or subsequent to June 30, 2018, but were fully accrued as of the balance sheet date, including a specific case disclosed as a material contingency in the footnotes to the 2017 audited consolidated financial statements.

Litigation

Devereux and DCW are contingently liable in connection with certain claims and contracts arising in the normal course of their activities. After consultation with legal counsel, management believes these matters will be resolved without a material adverse effect on Devereux's future financial position or results from operations.

Devereux is not a party to, nor are any of its properties the subject of, any material, pending legal proceedings other than ordinary, routine litigation incidental to the business.

Florida Single Audit

The Devereux Foundation and Controlled Entities
d/b/a Devereux Advanced Behavioral Health

Schedule of Expenditures of State Financial Assistance

Year Ended June 30, 2018

State Project NameState Project Title	Contracts	CSFA Number	Total Expenditures
Brevard Family Partnership	OHC RA-1608, RGC1405	60.138	$ 139,915
Community Based Care of Central Florida	SEMOROS011-1718	60.138	68,530
Department of Children & Families	GJ504	60.138	700,000
Total 60.138: Sexually Exploited Children			908,445
Heartland for Children	NDXMS1	60.074	25,937
Eckerd	Funding Letters	60.074	287,173
Kids Central	C1718-PRV-D031	60.074	136,846
Community Based Care of Central Florida	OROS007-1718	60.074	210,363
Community Based Care of Central Florida	SEMOROS011-1718	60.074	15,876
Community Partnership for Children	D12-17-DEV-CPA, D12-17-DEV-DD, D12-17-DEV-FBSS	60.074	11,325
Children's Network of Southwest Florida	DBN03	60.074	36,325
Total 60.074: Out of Home Care Support			723,845
Heartland for Children	NDXMS1	60.075	10,771
Kids Central	C1718-DVR-D031	60.075	55,883
Kids Central	C1718-PRV-D031	60.075	8,945
Community Based Care of Central Florida	SEMOROS011-1718	60.075	102,505
Total 60.075: In Home Care Support			178,104
Community Based Care of Central Florida	OROS003-1721	60.112	10,097
Total 60.112: Independent Living Program			10,097
Community Based Care of Central Florida	OROS003-1721	60.141	10,097
Total 60.141: Extended Foster Care			10,097
Total Expenditures of State Financial Assistance			$ 1,830,588

See accompanying notes to the Schedule of Expenditures of State Financial Assistance.

Notes to the Schedule of Expenditures of State Financial Assistance

Year Ended June 30, 2018

1. Basis of Presentation

The accompanying schedule of expenditures of state financial assistance includes the state financial assistance project activity of The Devereux Foundation and Controlled Entities (Devereux) and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of Section 215.97, *Florida Statutes,* and Chapter 10.650, *Rules of the Auditor General*.

2. Contingency

Project expenditures are subject to audit and adjustment. If any expenditure were to be disallowed by the grantor agency as a result of such an audit, any claim for reimbursement to the grantor agency would become a liability of Devereux. In the opinion of management, all state financial assistance project expenditures included on the accompanying schedule are in compliance with the terms of the project agreements and applicable state laws and regulations.

Building a better working world

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Report of Independent Auditors on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance With *Government Auditing Standards*

The Board of Trustees
The Devereux Foundation and Controlled Entities
d/b/a Devereux Advanced Behavioral Health

We have audited, in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of The Devereux Foundation and Controlled Entities d/b/a Devereux Advanced Behavioral Health (Devereux), which comprise the consolidated balance sheet as of June 30, 2018, 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 consolidated financial statements, and have issued our report thereon dated September 25, 2018.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Devereux's internal control over financial reporting (internal control) to determine the 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 Devereux's internal control. Accordingly, we do not express an opinion on the effectiveness of Devereux'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 combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Devereux's financial statements are free of 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*.

Purpose of This Report

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

Ernst + Young LLP

September 25, 2018

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Report of Independent Auditors on Compliance for Each Major State Financial Assistance Project and Report on Internal Control Over Compliance Required by Section 215.97, *Florida Statutes*, and Chapter 10.650, *Rules of the Auditor General*

The Board of Trustees
The Devereux Foundation and Controlled Entities
d/b/a Devereux Advanced Behavioral Health

Report on Compliance for Each Major State Financial Assistance Project

We have audited The Devereux Foundation and Controlled Entities d/b/a Devereux Advanced Behavioral Health's (Devereux) compliance with the types of compliance requirements described in the Executive Office of the Governor's State Projects Compliance Supplement that could have a direct and material effect on each of Devereux's major state programs for the year ended June 30, 2018. Devereux's major state 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 the state statutes, regulations and the terms and conditions of its state financial assistance projects.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of Devereux's major state financial assistance projects 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; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; Section 215.97, *Florida Statutes;* and Chapter 10.650, *Rules of the Auditor General*. Those standards and Section 215.97, *Florida Statutes*, and Chapter 10.650, *Rules of the 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 state financial assistance project occurred. An audit includes examining, on a test basis, evidence about Devereux'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 state financial assistance project. However, our audit does not provide a legal determination of Devereux's compliance.

Opinion on Each Major State Financial Assistance Project

In our opinion, Devereux 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 state financial assistance projects for the year ended June 30, 2018.

Report on Internal Control Over Compliance

Management of Devereux 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 Devereux's internal control over compliance with the types of requirements that could have a direct and material effect on each major state financial assistance project to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major state financial assistance project and to test and report on internal control over compliance in accordance with Section 215.97, *Florida Statutes,* and Chapter 10.650, *Rules of the 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 Devereux'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 state financial assistance project on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or 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 state financial assistance project 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 state financial assistance project that is less severe than a material weakness in internal control over compliance, 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. We did not identify any deficiencies in 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 Executive Office of the Governor's State Projects Compliance Supplement. Accordingly, this report is not suitable for any other purpose.

Ernst + Young LLP

December 21, 2018

The Devereux Foundation and Controlled Entities
d/b/a Devereux Advanced Behavioral Health

Schedule of Findings and Questioned Costs

Year Ended June 30, 2018

Part I – Summary of Auditor's Results

Financial Statements Section

Type of report the auditor issued on whether the financial statements audited were prepared in accordance with GAAP:	Unmodified	
Internal control over financial reporting:		
Material weaknesses identified?	______ Yes	✓ No
Significant deficiencies identified?	______ Yes	✓ None reported
Non-compliance material to financial statements noted?	______ Yes	✓ No

State Financial Assistance Projects

Internal control over major programs:		
Material weaknesses identified?	______ Yes	✓ No
Significant deficiencies identified?	______ Yes	✓ None reported
Type of auditor's report issued on compliance for major state financial assistance projects:	Unmodified	
Any audit findings disclosed that are required to be reported in accordance with Section 215.97, *Florida Statutes*, and Chapter 10.650, *Rules of the Auditor General*?	______ Yes	✓ No

Identification of Major State Financial Assistance Projects

CSFA Numbers	Name of State Financial Assistance Project or Cluster
60.074	Out-of-Home Care Support
60.138	Sexually Exploited Children

Dollar threshold used to distinguish between Type A and Type B programs: $300,000

Part II – Financial Statement Findings

None noted.

Part III – Federal Award Findings and Questioned Costs

None noted.

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