

Consolidated Financial Statements and Independent Auditors'
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 AND AFFILIATES

For the years ended June 30, 2018 and 2017

PHOENIX HOUSE AND AFFILIATES

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GRANT THORNTON LLP

757 Third Ave., 9th Floor
New York, NY 10017-2013

D +1 212 599 0100

F +1 212 370 4520

S [linkd.in/grantthorntonus](https://www.linkedin.com/company/grantthorntonus)

twitter.com/grantthorntonus

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

To the Board of Directors of
Phoenix House and Affiliates

Report on the financial statements

We have audited the accompanying consolidated financial statements of Phoenix House and Affiliates (“PH&A”), which comprise the consolidated statements of financial position as of June 30, 2018 and 2017, and the related consolidated statements of activities and cash flows for the years then ended, and the related notes to the financial statements.

Management’s responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor’s responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to PH&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 PH&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 and Affiliates as of June 30, 2018 and 2017, and the changes in their net assets and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of matters

As further detailed in Note 1 to the accompanying consolidated financial statements, PH&A has a working capital deficit and recurring operating losses. Management's evaluation of the events and conditions and management's plans to mitigate these matters are also described in Note 1. Our opinion is not modified with respect to these matters.

As further detailed in Note 1 to the accompanying consolidated financial statements, subsequent to June 30, 2018, the Phoenix House Board of Directors voted to dissolve the sole corporate member (the Phoenix House parent entity, incorporated in Minnesota). The effect of this dissolution will cause each regional Phoenix House affiliate and Phoenix House Foundation, Inc. to become stand-alone entities, with self-governing boards.

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, 2018 and 2017 and the Schedule of Expenditures of Federal and State of Florida awards, as required by 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 audits 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 May 3, 2019, on our consideration of PH&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 solely 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 PH&A's 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 PH&A's internal control over financial reporting and compliance.

Grant Thornton LLP

New York, New York

May 3, 2019

PHOENIX HOUSE AND AFFILIATES
Consolidated Statements of Financial Position
As of June 30, 2018 and 2017

	<u>2018</u>	<u>2017</u>
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 17,640,368	\$ 26,919,179
Due from government agencies, net of allowance of approximately \$3,477,000 and \$1,782,000 in 2018 and 2017, respectively	10,667,871	8,590,653
Current portion of contributions receivable, net (Note 5)	336,503	347,559
Other receivables, net of allowance of approximately \$2,398,000 and \$1,340,000 in 2018 and 2017, respectively	1,840,666	3,258,751
Donated goods and inventories	36,873	31,851
Properties held for sale (Note 7)	19,377,428	6,963,349
Prepaid expenses and other assets	3,621,028	3,178,620
Current portion of notes receivable (Note 6)	15,701	5,000
Total current assets	<u>53,536,438</u>	<u>49,294,962</u>
Contributions receivable, net (Note 5)	-	131,756
Notes receivable, net of current portion (Note 6)	665,930	150,000
Investments, at fair value (Note 4)	4,810,700	3,485,045
Property and equipment, net (Note 7)	36,480,759	53,857,287
Total assets	<u>\$ 95,493,827</u>	<u>\$ 106,919,050</u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Accounts payable and accrued expenses	\$ 11,902,002	\$ 11,550,849
Agency funds (Note 8)	80,456	88,856
Current portion of amounts due to government agencies	5,226,319	8,315,105
Current portion of capital lease obligations	34,303	32,382
Current portion of long-term debt (Note 9)	40,334,519	667,023
Total current liabilities	<u>57,577,599</u>	<u>20,654,215</u>
Due to government agencies, net of current portion	-	265,408
Capital lease obligations, net of current portion	105,197	139,500
Conditional asset retirement obligations (Note 2)	57,459	3,220,043
Long-term debt, net of current portion (Note 9)	5,272,843	31,745,862
Total liabilities	<u>63,013,098</u>	<u>56,025,028</u>
Commitments and contingencies (Note 14)		
NET ASSETS		
Unrestricted	24,541,091	41,873,107
Temporarily restricted (Note 11)	4,422,900	5,504,177
Permanently restricted (Note 11)	3,516,738	3,516,738
Total net assets	<u>32,480,729</u>	<u>50,894,022</u>
Total liabilities and net assets	<u>\$ 95,493,827</u>	<u>\$ 106,919,050</u>

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

PHOENIX HOUSE AND AFFILIATES
Consolidated Statement of Operations and Changes in Net Assets
For the year ended June 30, 2018

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
OPERATING REVENUES AND SUPPORT				
Government contract revenue	\$ 50,267,750	\$ -	\$ -	\$ 50,267,750
Client and third-party revenue (Note 10)	35,555,587	-	-	35,555,587
Donated goods and services	3,739,822	-	-	3,739,822
Grants and contributions	756,553	1,157,762	-	1,914,315
Special events revenue, net of costs of direct benefits to donors of approximately \$1,000	1,575	-	-	1,575
Other revenue	118,861	-	-	118,861
Investment income designated for operations (Note 4)	230,651	-	-	230,651
Net assets released from restrictions	415,422	(415,422)	-	-
Total operating revenues and support	<u>91,086,221</u>	<u>742,340</u>	<u>-</u>	<u>91,828,561</u>
OPERATING EXPENSES (Note 13)				
Salaries	56,835,479	-	-	56,835,479
Employee benefits and payroll taxes	14,569,825	-	-	14,569,825
Consulting and contractual services	10,669,215	-	-	10,669,215
Resident sustenance	3,854,264	-	-	3,854,264
Occupancy costs	6,412,050	-	-	6,412,050
Vehicle costs	661,513	-	-	661,513
Communications	1,996,422	-	-	1,996,422
Supplies	2,714,328	-	-	2,714,328
Insurance	2,463,292	-	-	2,463,292
Travel	1,061,748	-	-	1,061,748
Interest	2,833,943	-	-	2,833,943
Miscellaneous	1,671,865	-	-	1,671,865
Repairs and maintenance	2,227,126	-	-	2,227,126
Depreciation and amortization	4,591,405	-	-	4,591,405
Total operating expenses	<u>112,562,475</u>	<u>-</u>	<u>-</u>	<u>112,562,475</u>
(Loss) income from operations	<u>(21,476,254)</u>	<u>742,340</u>	<u>-</u>	<u>(20,733,914)</u>
OTHER ITEMS				
Gain on write-down of conditional asset retirement obligation (Note 2)	3,164,570	-	-	3,164,570
Loss on sale and disposal of properties (Note 7)	(706,615)	-	-	(706,615)
Investment (loss) gain, net of amounts designated for operations	(289,720)	303,231	-	13,511
Accretion of interest on conditional asset retirement obligations	(1,986)	-	-	(1,986)
Depreciation on capital assets funded by government grants	(696,571)	-	-	(696,571)
Loss on impairment of property held for sale (Note 7)	(287,587)	-	-	(287,587)
Other	442,647	(2,470)	-	440,177
Total other items	<u>1,624,738</u>	<u>300,761</u>	<u>-</u>	<u>1,925,499</u>
(Deficiency in) excess of revenues and support over expenses and other items	<u>(19,851,516)</u>	<u>1,043,101</u>	<u>-</u>	<u>(18,808,415)</u>
OTHER CHANGES IN NET ASSETS				
Net assets released from restrictions for capital expenditures	2,519,500	(2,519,500)	-	-
Capital contributions	-	395,122	-	395,122
Deficiency in revenues and support over expenses, other items and changes in net assets	<u>(17,332,016)</u>	<u>(1,081,277)</u>	<u>-</u>	<u>(18,413,293)</u>
Net assets, beginning of year	<u>41,873,107</u>	<u>5,504,177</u>	<u>3,516,738</u>	<u>50,894,022</u>
Net assets, end of year	<u>\$ 24,541,091</u>	<u>\$ 4,422,900</u>	<u>\$ 3,516,738</u>	<u>\$ 32,480,729</u>

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

PHOENIX HOUSE AND AFFILIATES
Consolidated Statement of Operations and Changes in Net Assets
For the year ended June 30, 2017

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
OPERATING REVENUES AND SUPPORT				
Government contract revenue	\$ 57,103,286	\$ -	\$ -	\$ 57,103,286
Client and third-party revenue (Note 10)	44,084,177	-	-	44,084,177
Donated goods and services	1,053,372	-	-	1,053,372
Grants and contributions	633,160	823,008	-	1,456,168
Special events revenue, net of costs of direct benefits to donors of approximately \$168,000	957,883	-	-	957,883
Other revenue	363,944	-	-	363,944
Investment income designated for operations (Note 4)	259,742	-	-	259,742
Net assets released from restrictions	962,442	(962,442)	-	-
Total operating revenues and support	<u>105,418,006</u>	<u>(139,434)</u>	<u>-</u>	<u>105,278,572</u>
OPERATING EXPENSES (Note 13)				
Salaries	61,992,827	-	-	61,992,827
Employee benefits and payroll taxes	14,826,266	-	-	14,826,266
Consulting and contractual services	10,005,286	-	-	10,005,286
Resident sustenance	4,517,735	-	-	4,517,735
Occupancy costs	7,444,518	-	-	7,444,518
Vehicle costs	835,149	-	-	835,149
Communications	2,204,725	-	-	2,204,725
Supplies	2,703,537	-	-	2,703,537
Insurance	2,796,317	-	-	2,796,317
Travel	1,298,770	-	-	1,298,770
Interest	950,259	-	-	950,259
Miscellaneous	1,709,719	-	-	1,709,719
Repairs and maintenance	2,428,470	-	-	2,428,470
Depreciation and amortization	3,611,541	-	-	3,611,541
Total operating expenses	<u>117,325,119</u>	<u>-</u>	<u>-</u>	<u>117,325,119</u>
Loss from operations	<u>(11,907,113)</u>	<u>(139,434)</u>	<u>-</u>	<u>(12,046,547)</u>
OTHER ITEMS				
Loss on sale and disposal of properties	(510,653)	-	-	(510,653)
Investment (loss) gain, net of amounts designated for operations	(298,481)	587,349	-	288,868
Accretion of interest on conditional asset retirement obligations	(1,986)	-	-	(1,986)
Loss on write-down of properties (Note 7)	-	-	-	-
Depreciation on capital assets funded by government grants	(718,364)	-	-	(718,364)
Re-designation of permanently restricted contributions by donor	-	475,000	(475,000)	-
Gain on write-down of conditional asset retirement obligations (Note 2)	191,984	-	-	191,984
Total other items	<u>(1,337,500)</u>	<u>1,062,349</u>	<u>(475,000)</u>	<u>(750,151)</u>
(Deficiency in) excess of revenues and support over expenses and other items	<u>(13,244,613)</u>	<u>922,915</u>	<u>(475,000)</u>	<u>(12,796,698)</u>
OTHER CHANGES IN NET ASSETS				
Net assets released from restrictions for capital expenditures	4,461,369	(4,461,369)	-	-
Capital contributions	-	3,648,300	-	3,648,300
(Deficiency in) excess of revenues and support over expenses, other items and changes in net assets	<u>(8,783,244)</u>	<u>109,846</u>	<u>(475,000)</u>	<u>(9,148,398)</u>
Net assets, beginning of year	<u>50,656,351</u>	<u>5,394,331</u>	<u>3,991,738</u>	<u>60,042,420</u>
Net assets, end of year	<u>\$ 41,873,107</u>	<u>\$ 5,504,177</u>	<u>\$ 3,516,738</u>	<u>\$ 50,894,022</u>

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

PHOENIX HOUSE AND AFFILIATES
Consolidated Statements of Cash Flows
For the years ended June 30, 2018 and 2017

	<u>2018</u>	<u>2017</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Changes in net assets	\$(18,413,293)	\$ (9,148,398)
Adjustments to reconcile changes in net assets to net cash used in operating activities:		
Gain on write-down of conditional asset retirement obligation	(3,164,570)	(191,701)
Loss on sale and disposal of properties	706,615	510,653
Loss on impairment of property held for sale	287,587	-
Forgiveness of notes receivable	5,000	5,000
Net realized and unrealized gain on fair value of investments	(242,046)	(556,911)
Accretion of interest on conditional asset retirement obligations	1,986	1,986
Amortization of discount on contributions receivable	(18,244)	(2,488)
Changes in provision for doubtful accounts	2,753,715	(1,256,349)
Depreciation and amortization	5,287,976	4,329,905
Contributions restricted for capital expenditures and long-term investment	(395,122)	(3,648,300)
Changes in operating assets and liabilities:		
Due from government agencies	(3,772,720)	3,563,244
Receivables	359,872	113,086
Donated goods and inventories	(5,022)	2,944
Contributions receivable	161,056	155,186
Prepaid expenses and other assets	(911,473)	769,645
Notes receivable	(531,631)	-
Accounts payable and accrued expenses	351,153	835,151
Agency funds	(8,400)	(83,702)
Other liabilities	-	(2,350,001)
Due to government agencies	(3,354,194)	(5,505,230)
Net cash used in operating activities	<u>(20,901,755)</u>	<u>(12,456,280)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(8,194,013)	(16,572,146)
Proceeds from sales of properties	8,144,221	1,136,896
Proceeds from sales of investments	505,990	642,638
Purchases of investments	(1,589,599)	(639,442)
Net cash used in investing activities	<u>(1,133,401)</u>	<u>(15,432,054)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Contributions restricted for capital expenditures and long-term investment	395,122	3,648,300
Proceeds from long-term debt	15,000,000	15,000,000
Principal payments on long-term debt	(1,805,523)	(5,860,955)
Issuance costs on new debt	(800,872)	(1,318,031)
Principal payments on capital lease obligations	(32,382)	(7,808)
Net cash provided by financing activities	<u>12,756,345</u>	<u>11,461,506</u>
Net decrease in cash and cash equivalents	(9,278,811)	(16,426,828)
Cash and cash equivalents, beginning of year	<u>26,919,179</u>	<u>43,346,007</u>
Cash and cash equivalents, end of year	<u>\$ 17,640,368</u>	<u>\$ 26,919,179</u>
Supplemental disclosure of cash flow information:		
Interest paid, including capitalized interest	<u>\$ 3,424,000</u>	<u>\$ 1,481,000</u>
Capital lease obligations incurred	<u>\$ -</u>	<u>\$ 180,000</u>

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

PHOENIX HOUSE AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

1. ORGANIZATION AND LIQUIDITY

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

Through June 30, 2016, Phoenix House Foundation, Inc. was 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.

On April 11, 2016, a new corporation, named “Phoenix House,” was incorporated in the State of Minnesota. Phoenix House is a nonprofit corporation which on September 29, 2017 was granted recognition of its federal tax exempt status as an organization described in Internal Revenue Code § 501(c)(3) effective retroactively to its formation on April 11, 2016.

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.

During fiscal 2017, Phoenix House Riverwalk, LLC (“Riverwalk”) was formed for the purpose of holding certain real and personal assets, which were transferred to Riverwalk from Phoenix House Foundation, Inc. and Phoenix Houses of New York, Inc. during the year ended June 30, 2017. Riverwalk also assumed the obligation for the \$10 million loan with 42-50 Jay Street, LLC, the creditor, which was originally entered into by Phoenix House Foundation, Inc. Riverwalk is a disregarded entity for tax purposes with Phoenix House Foundation, Inc. being its sole member.

During fiscal 2018, Phoenix House Parkside, LLC (“Parkside”) was formed for the purpose of holding certain real and personal assets, which were transferred to Parkside from Phoenix Houses of New York, Inc. during fiscal 2018. Parkside is a disregarded entity for tax purposes with Phoenix House Foundation, Inc. being its sole member.

Phoenix House 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 and Affiliates are also exempt from state and local income taxes.

PHOENIX HOUSE AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

The accompanying 2018 and 2017 consolidated financial statements reflect losses from operations totaling \$20,733,914 and \$12,046,547, respectively, and negative cash flows from operations totaling \$20,901,755 and \$12,456,280, respectively.

Accordingly, in order to address the structural concerns and persistent operational deficits as well as ensure the long-term viability and delivery of PH&A's mission, PH&A has undertaken a restructuring plan. The thrust of the restructuring plan is to right-size the infrastructure and adjust the revenue mix with the principal goal of improving cash flows and ensuring the sustainability of the regional affiliates. In connection with the implementation of this plan, PH&A performed an evaluation of its programs and related funding arrangements and opted to discontinue certain programs yielding minimal to low margin. While PH&A continues to believe in the importance of continuing to serve primarily indigent populations, it will endeavor to improve operating performance via cost containment and incremental revenue growth by adding billing for professional services and expanding into commercial insurance contracts, where determined to be feasible.

Phoenix House recognizes that each regional affiliate has a unique client base and competitive and operational issues, and that the regions solve for these issues in disparate ways. PH&A believes a renewed focus at the regional affiliate level presents the only viable approach forward from both an operational and financial perspective. Accordingly, in response to these factors, and subsequent to June 30, 2018, the Phoenix House Board of Directors voted to dissolve the sole corporate member (the Phoenix House parent entity, incorporated in Minnesota). The effect of this dissolution will cause each regional Phoenix House affiliate and Phoenix House Foundation, Inc. to become stand-alone entities. The boards of these regional Phoenix House affiliates will become self-governing operating boards, all inter-company balances, as of the dissolution date, will either be settled in cash or forgiven, and Phoenix House Foundation, Inc. will license the name and intellectual property ("IP") to each regional Phoenix House affiliate, at no cost. Following the dissolution, Phoenix House Foundation, Inc. will not hold any licenses for the delivery of programs. However, Phoenix House Foundation, Inc. will continue to control Phoenix House Parkside, which owns the real property at the Long Island City location, will continue to manage certain donor-restricted assets/net assets totaling \$4.9 million, will maintain a cash balance to be held as a reserve to provide for other operating costs that will be incurred and will license the IP, described above.

In order to address short-term liquidity concerns, Phoenix House has secured additional bridge financing collateralized by real estate (see Note 9 for further details). A portion of this loan included the establishment of a reserve, held by the creditor, totaling \$3 million (\$1 million to pay origination fees and \$2 million to be held as a reserve to service the \$7 million loan through April 2020). In March 2019, Phoenix House sold its Riverwalk property, at a sales price of \$52,250,000 (see Note 7 for further details), and used the net proceeds from the sale to repay a portion of its high-interest rate debt and provide a sufficient level of liquidity to the regional Phoenix House affiliates in order for them to commence operations as stand-alone entities (see below for further details). Following the pay-down of a substantial portion of the debt, which existed at June 30, 2018, the remaining property sales proceeds together with other available funds, are anticipated to be used in the following manner: \$10 million of working capital distributions will be made to the regions; settlement of certain intercompany balances, \$5 million; funding of employee retirement plan and workers compensation obligations, \$1.6 million; and providing for certain other operating costs, primarily information technology, insurance and other, \$4 million. This remaining balance includes reserving for legal and operational costs that could be incurred in the future.

Following the effectuation of the dissolution of the sole corporate member, which was approved by the Board in March 2019, Phoenix House will have no further obligation to support the stand-alone regional

PHOENIX HOUSE AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

affiliates. Accordingly, the accompanying consolidated financial statements and related disclosures do not contemplate the ability of the stand-alone Phoenix House regional affiliates to continue in operation post the dissolution date of the sole corporate member.

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 preparation of the accompanying consolidated financial statements. The net assets of PH&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 PH&A’s operations and are not subject to donor-imposed stipulations.
- Temporarily restricted net assets contain donor-imposed restrictions that permit PH&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 PH&A.
- Permanently restricted net assets contain donor-imposed restrictions that stipulate that such resources be maintained permanently, but permit PH&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, the determination of year-end operating accruals, 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

PH&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.

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Level 2 - Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data. Level 2 assets and liabilities include corporate debt securities with quoted market prices that are traded less frequently than exchange-traded instruments.

Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the asset or liability being measured. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

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

Cash and Cash Equivalents

PH&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. Donated goods and inventories received during the fiscal years ended June 30, 2018 and 2017 total approximately \$217,000 and \$300,000, respectively. At June 30, 2018 and 2017, unexpended donated goods and inventories on-hand amount to approximately \$37,000 and \$32,000, respectively.

Contributed Services

PH&A receives certain contributed services that meet criteria established by US GAAP for recognition as contributions. Such services (primarily legal and teaching services) are recorded at fair value, which for fiscal years 2018 and 2017 totaled approximately \$3,523,000 and \$1,070,000, respectively, and are included as revenues 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. PH&A capitalizes assets acquired for greater than \$1,000 and

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with useful lives greater than two years. Depreciation is computed on the straight-line basis over the estimated useful lives of the assets as follows:

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

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

Costs incurred for repairs, maintenance and minor improvements that do not substantially extend an asset's useful life are charged to expense as incurred. Major improvements, which substantially extend the useful lives of assets, are capitalized. Interest costs incurred on borrowed funds during the period of construction of capital assets are capitalized as a component of the cost of acquiring those assets. Interest amounting to approximately \$585,000 and \$534,000 was capitalized for the years ended June 30, 2018 and 2017, respectively, and is included within property and equipment in the consolidated statements of financial position.

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. There were contributions of approximately \$395,000 and \$3,648,000 restricted by donors for the acquisition of property and equipment received during the years ended June 30, 2018 and 2017, respectively.

Amounts Due to Government Agencies

As of June 30, 2017, PH&A has reflected as amounts due to government agencies (non-current) refundable cash advances pertaining to construction projects at its East Hampton, New York facility totaling approximately \$236,000 and has reflected as current portion of amounts due to government agencies 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 PH&A's Yorktown facility. The remaining balance of amounts due to government agencies as of June 30, 2017 pertains to government contracts in the New York and California regions, principally the New York Office of Alcoholism and Substance Abuse Services and the Los Angeles Department of Mental Health. During fiscal 2015, PH&A decided to sell its Yorktown facility and accordingly was required to refund the advances received using the sales proceeds from the property. During fiscal 2018, the sale of the Yorktown property closed and the amounts refundable to the State of New York were repaid. Amounts due to government agencies as of June 30, 2018 pertain to

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government contracts in the New York and California regions, principally the New York Office of Alcoholism and Substance Abuse Services and the Los Angeles Department of Mental Health.

Government Contract Revenue

PH&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 PH&A and any adjustments by grantors would be recorded when amounts are known; however, it is the opinion of PH&A that disallowances (if any) would be immaterial, and adjustments (if any) would not have a material adverse effect on PH&A's consolidated financial statements. PH&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 on the statement of operations and changes in net assets.

PH&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 upon pre-determined rates. Medicaid and managed Medicaid approximated 52% and 45% of total client and third-party revenue for the years ended June 30, 2018 and 2017, 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. PH&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

PH&A follows guidance that 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 guidance provides that the tax effects from an uncertain tax position can only be recognized in the financial statements if the position is "more-likely-than-not" to be sustained if the position were to be challenged by a taxing authority. The assessment of the tax position is based solely on the technical merits of the position, without regard to the likelihood that the tax position may be challenged.

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PH&A is exempt from federal income tax under IRC Section 501(c)(3), though it is subject to tax on income unrelated to its exempt purpose, unless that income is otherwise excluded by the Code. PH&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. PH&A has determined that there are no material uncertain tax positions that require recognition or disclosure in the accompanying consolidated financial statements.

Conditional Asset Retirement Obligations

Conditional Asset Retirement Obligations (“CARO”) are legal obligations associated with the retirement of long-lived assets. PH&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. During fiscal year 2018 and 2017, due to the sale of certain facilities for which a CARO liability had been recorded, \$3,165,000 and \$192,000, respectively, of the CARO liability were written off and are reflected within gain on write-down of conditional asset retirement obligation on the accompanying consolidated statements of operations and changes in net assets. For the years ended June 30, 2018 and 2017, the accretion of interest associated with CAROs totaled approximately \$2,000. At June 30, 2018 and 2017, property and equipment includes capitalized conditional asset retirement obligations at an approximate cost of \$19,000 and \$479,000, respectively, and accumulated depreciation of approximately \$19,000 and \$479,000, respectively. The CARO liability at June 30, 2018 and 2017 totaled approximately \$57,000 and \$3,220,000, respectively. Other than the CAROs that were written off, none of the CAROs were settled during fiscal 2018 or 2017.

Statement of Operations and Changes in Net Assets

PH&A’s operating loss includes all unrestricted revenues and expenses. Other items include loss on sale and disposal of properties, 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, gain on write-down of conditional asset retirement obligations, and other items. The consolidated statement of operations and changes in net assets also includes the caption “(Deficiency in) excess of 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), and net assets released from restriction for capital expenditure.

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, PH&A has a diversified investment portfolio in a variety of asset classes managed by an independent investment manager. PH&A’s cash, cash equivalents and investments are placed with high credit quality financial institutions. PH&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. PH&A maintains its cash in various bank deposit accounts that, at times, may exceed federally insured limits; however, PH&A does not anticipate nonperformance by these financial institutions.

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PH&A provides drug and alcohol rehabilitation services through its inpatient and outpatient care facilities. PH&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). Amounts due from government agencies and other receivables by financial class as a percentage of total accounts receivable at June 30, 2018 and 2017, are as follows:

	<u>2018</u>	<u>2017</u>
Medicaid	37 %	19 %
Commercial insurance	18	27
Other third-party payors	44	53
Self-pay	<u>1</u>	<u>1</u>
	<u>100 %</u>	<u>100 %</u>

Subsequent Events

PH&A evaluated its June 30, 2018 consolidated financial statements for subsequent events through May 3, 2019, the date the consolidated financial statements were available to be issued. PH&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 this note as well as Notes 1, 7 and 9.

3. RELATED PARTY TRANSACTIONS

PH&A received donated legal services from certain related parties (primarily legal services from law firms associated with certain board members) totaling approximately \$2,796,000 and \$806,000 for the years ended June 30, 2018 and 2017, respectively, and are recorded as part of donated goods and services revenues, and consulting and contractual services expense on the accompanying consolidated statements of operations and changes in net assets and as deferred financing costs, which are reflected as a reduction of long-term debt on the consolidated statements of financial position.

4. INVESTMENTS

Investments, at fair value, at June 30, 2018 and 2017, consist approximately of the following:

	<u>2018</u>	<u>2017</u>
Equities	\$ 3,545,000	\$ 2,342,000
Foreign equities	305,000	237,000
Commercial paper and money market funds	<u>961,000</u>	<u>906,000</u>
	<u>\$ 4,811,000</u>	<u>\$ 3,485,000</u>

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The following table presents PH&A's investments within the fair value hierarchy as of June 30, 2018:

	<u>Fair Value</u>	<u>Level 1</u>
Equities	\$ 3,850,000	\$ 3,850,000
Commercial paper and money market funds	<u>961,000</u>	<u>961,000</u>
	<u>\$ 4,811,000</u>	<u>\$ 4,811,000</u>

The following table presents PH&A's investments within the fair value hierarchy as of June 30, 2017:

	<u>Fair Value</u>	<u>Level 1</u>
Equities	\$ 2,579,000	\$ 2,579,000
Commercial paper and money market funds	<u>906,000</u>	<u>906,000</u>
	<u>\$ 3,485,000</u>	<u>\$ 3,485,000</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 for the years ended June 30, 2018 and 2017 consist approximately of the following:

	<u>2018</u>	<u>2017</u>
Net realized and unrealized gains	\$ 242,000	\$ 557,000
Interest and dividends	<u>71,000</u>	<u>72,000</u>
	313,000	629,000
Less: Investment advisory and custodian fees	<u>(69,000)</u>	<u>(80,000)</u>
	<u>\$ 244,000</u>	<u>\$ 549,000</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 11 for endowment investment spending). In accordance with the spending rate, approximately \$231,000 and \$260,000 of investment income was made available in support of operations in fiscal years 2018 and 2017, respectively.

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5. CONTRIBUTIONS RECEIVABLE, NET

At June 30, 2018 and 2017, contributions receivable, net, consist approximately of the following:

	<u>2018</u>	<u>2017</u>
Amounts expected to be collected in:		
Less than one year	\$ 337,000	\$ 348,000
One to two years	<u>-</u>	<u>150,000</u>
	337,000	498,000
Less: Discount to present value (at a rate of 0.28%)	<u>-</u>	<u>(19,000)</u>
	<u>\$ 337,000</u>	<u>\$ 479,000</u>

Because of the uncertainty surrounding the collection of certain contributions receivable, from time to time 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, PH&A will re-evaluate the recoverability of any contributions receivable from that donor. PH&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 20 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 12th calendar month after such date. The principal due shall be reduced by \$5,000 each year for the initial 20 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 12th 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, 2018 and 2017, the balance of this note receivable was \$75,000 and \$80,000, 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 25 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 12th 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, 2018 and 2017, 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, 2018 and 2017.

During October 2017, Phoenix House Foundation entered into a promissory note agreement with 3151 Stoney Street, LLC in connection with the sale of the Yorktown property. The principal of the note totals \$538,250, carries an annual interest rate of 9%, and repayments are due monthly through the maturity date of October 2037. The note is secured by investment securities pledged by the borrower. At June 30, 2018, the balance of this note receivable was approximately \$532,000.

7. PROPERTY AND EQUIPMENT, NET

At June 30, 2018 and 2017, property and equipment, net, consists approximately of the following:

	<u>2018</u>	<u>2017</u>
Depreciable assets		
Buildings and improvements	\$ 55,194,000	\$ 61,474,000
Furniture, fixtures and equipment	5,992,000	5,391,000
Computer equipment and software	22,349,000	22,083,000
Vehicles	<u>558,000</u>	<u>583,000</u>
	84,093,000	89,531,000
Non-depreciable assets		
Land	7,746,000	7,689,000
Construction-in-progress	<u>3,540,000</u>	<u>19,183,000</u>
	95,379,000	116,403,000
Less: Accumulated depreciation and amortization	<u>(58,898,000)</u>	<u>(62,546,000)</u>
	<u>\$ 36,481,000</u>	<u>\$ 53,857,000</u>

Construction-in-progress at June 30, 2018 and 2017 consists primarily of renovation costs incurred at the Florida and New York facilities. At June 30, 2018, the remaining costs anticipated to complete renovation projects total approximately \$1,564,000. The balance of project costs will be funded through restricted gifts and operating funds. These projects are expected to be completed during fiscal 2019.

During fiscal 2018, Phoenix House Foundation, Inc.’s Board of Directors passed a resolution to place on the market with the intent to sell its Riverwalk property. No impairment loss was recognized as the carrying value of this property was less than its fair value. As of June 30, 2018, the net book value of the property was approximately \$18,751,000 which is included in properties held for sale in the accompanying

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2018 consolidated statement of financial position. During March 2019, the sale of the property closed at a selling price of \$52,250,000.

During fiscal 2017, Phoenix Houses of California, Inc.'s Board of Directors passed a resolution to place on the market with the intent to sell its Descanso property. As of June 30, 2017, the net book value of the property was approximately \$857,000. During fiscal 2018, the property was written down to an assessed fair value, less selling costs of \$570,000. These balances are included within properties held for sale in the accompanying consolidated statements of financial position. The impairment recorded in fiscal 2018 of approximately \$287,000 is reflected within loss on impairment of property held for sale on the accompanying 2018 consolidated statement of operations and changes in net assets.

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 part of properties held for sale on the accompanying consolidated statements of financial position.

PH&A's properties held for sale are recurring fair value measurements and are therefore classified as follows at June 30, 2018 and 2017 within the fair value hierarchy:

	2018		2017	
	Fair Value	Carrying Value	Fair Value	Carrying Value
Phoenix House Foundation, Inc. (Yorktown)	\$ -	\$ -	\$ 6,998,000	\$ 6,000,000
Phoenix Houses of California, Inc. (Descanso)	570,000	570,000	1,800,000	857,000
Phoenix House Foundation, Inc. (Riverwalk)	52,250,000	18,750,000	-	-
Phoenix Houses of Mid-Atlantic, Inc.	57,000	57,000	106,000	106,000
	<u>\$ 52,877,000</u>	<u>\$ 19,377,000</u>	<u>\$ 8,904,000</u>	<u>\$ 6,963,000</u>

The inputs used to report the fair value of the Descanso property 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 closed during October 2017.

During fiscal 2018, PH&A sold its Yorktown, Arlington, and Ottmar properties, as well as certain parcels of land in Virginia with an aggregate net book value of approximately \$7,313,000 for a sales price, net of selling costs, of approximately \$7,504,000. In addition, PH&A sold vehicles and other assets, and disposed of certain fixed assets with aggregate net book values of approximately \$8,618,000. In connection with these sales and disposals, PH&A recognized net losses of approximately \$707,000, which is reflected as loss on sale and disposal of properties on the accompanying 2018 consolidated statement of operations and changes in net assets.

During fiscal 2017, PH&A sold its Belle Terre Property with a net book value totaling approximately \$635,000 for a sales price, net of selling costs, of approximately \$879,000. In addition, PH&A sold vehicles and disposed of certain fixed assets with net book values of approximately \$965,000. In connection with these sales and disposals, PH&A recognized net losses of approximately \$511,000.

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During fiscal 2017, PH&A acquired certain networking equipment under a capital lease arrangement with a term of five years which is included in property and equipment. The networking equipment acquired under this capital lease arrangement had a cost of approximately \$180,000 and accumulated amortization is approximately \$45,000 and \$9,000 as of June 30, 2018 and 2017, respectively. Amounts outstanding under this capital lease are approximately \$140,000 and \$172,000 at June 30, 2018 and 2017, respectively, and are reflected in capital lease obligations on the accompanying consolidated statements of financial position.

8. AGENCY FUNDS

Agency funds consist principally of amounts received from government agencies, clients and others attributable and payable to specific individuals in PH&A's programs. Unexpended funds are to be returned to the respective agencies, clients or grantors. At June 30, 2018 and 2017, funds of approximately \$80,000 and \$89,000, respectively, are held on behalf of others by PH&A.

9. LONG-TERM DEBT

At June 30, 2018 and 2017, long-term debt consists of the following:

- Tax-exempt debt through the California Statewide Communities Development Authority ("CSCDA") and Wells Fargo Bank, N.A. Payments of principal and interest are based on 68% of the three-month LIBOR rate plus 1.25% (2.10% at June 30, 2017), calculated on a 25-year basis, and are due quarterly. During the year ended June 30, 2017, these interest rates ranged from 1.69% to 2.10%. The remaining balance of the debt was repaid in April 2018. The outstanding balance at June 30, 2017 was approximately \$509,000.
- Loan agreement with Valley National Bank. The loan is collateralized by property located in East Hampton, New York and Ronkonkoma, New York. 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, 2018 and 2017 was approximately \$1,734,000 and \$1,819,000, respectively.
- Loan agreement with Citizens Bank of Rhode Island payable in 120 monthly installments with a final balloon payment, including interest amortized over 15 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, Massachusetts. Amounts due under the mortgage are secured by property in Springfield, Massachusetts. At June 30, 2018 and 2017, the balance of the mortgage payable was approximately \$81,000 and \$98,000, 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, Virginia. The loan bears interest at a fixed rate of 5.00% per annum. At June 30, 2018 and 2017, the outstanding balance was approximately \$235,000 and \$240,000, 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, Virginia. 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

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resulted from this amendment. At June 30, 2018 and 2017, the balance of the mortgage payable was approximately \$3,505,000 and \$3,605,000, respectively.

- Loan agreement with Virginia Commerce Bank. The mortgage is payable in monthly installments of \$5,352 and bears a fixed rate of interest of 5.19%. The loan is secured by a first deed of trust on a building in Arlington, Virginia. The remaining balance of the loan was repaid in December 2017. The outstanding balance at June 30, 2017 was approximately \$471,000.
- Loan agreement with Old Colony Realty, LLC payable 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, Massachusetts. The remaining balance of the loan was repaid in December 2017. The outstanding balance at June 30, 2017 was approximately \$150,000.
- Loan agreement with Citizens Bank of Rhode Island payable 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 6th year of the loan at the Bank's Five Year Cost of Funds plus an additional 210 basis points 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, Massachusetts. Amounts due under the mortgage are secured by property in Providence, Rhode Island. The remaining balance of the loan was repaid in January 2018. The outstanding balance at June 30, 2017 was approximately \$426,000.
- Loan agreement with Plains Capital Bank which was entered into for the purchase of two vehicles. The loan is payable in 60 monthly installments through April 9, 2020, at a fixed rate of 5%. A portion of the loan was repaid in January 2018 in connection with the sale of one of the vehicles. At June 30, 2018 and 2017, the balance of the loan was approximately \$6,000 and \$24,000, 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 rates ranging between 4.95% and 5.85%. At June 30, 2018 and 2017, the aggregate balance of the loans totaled approximately \$46,000 and \$71,000, respectively.

On October 29, 2015, PH&A entered into a \$10 million loan agreement with 42-50 Jay Street, LLC, with an interest rate of prime plus 5.75% per annum. The loan is secured by the Jay Street property, with an original maturity date of October 29, 2016, which was later extended to October 29, 2018. On June 30, 2017, the loan was amended to change the interest rate to one-month LIBOR plus 7.85% with minimum and maximum interest rates of 8.85% and 10.85%, respectively, and extend the maturity date to June 29, 2019. Also on June 30, 2017, PH&A entered into an additional \$15 million loan agreement with the same lender, carrying the same interest and maturity terms as the amended \$10 million loan. The \$15 million loan is secured by the Jay Street property.

In January 2018, Parkside and Riverwalk (both disregarded single-member entities whose sole member is Phoenix House Foundation, Inc.), entered into a Consolidated, Amended and Restated Loan Agreement with 42-50 Jay Street, LLC and certain of its affiliates. By virtue of this agreement, an additional \$15 million advance was added to the outstanding \$25 million indebtedness, for a consolidated principal amount of \$40 million with an interest rate of 30-day LIBOR + 7.85% and subject to additional fees and the maintenance of a \$1.5 million interest reserve. The loan is secured by the Jay Street and Long Island City properties, matures on June 30, 2019, and allows for a 12-month extension option at PH&A's discretion.

PHOENIX HOUSE AND AFFILIATES
Notes to Consolidated Financial Statements
June 30, 2018 and 2017

At June 30, 2018 and 2017, the combined balance of the loans totaled \$40,000,000 and \$25,000,000, respectively.

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

2019	\$ 40,335,000
2020	213,000
2021	227,000
2022	1,578,000
2023	141,000
Thereafter	<u>3,113,000</u>
	<u>\$ 45,607,000</u>

During fiscal years 2018 and 2017, interest paid on these aforementioned long-term debt agreements, including capitalized interest, amounted to approximately \$3,424,000 and \$1,481,000, respectively.

In December 2018, Parkside and Riverwalk entered into a Second Consolidated, Amended and Restated Loan Agreement with 42-50 Jay Street, LLC, the creditor, which increased the loan balance by an additional \$7,000,000, to a total of \$47,000,000, and extended the maturity date of the loan to April 27, 2020 with a borrower option to extend for an additional three months. Following the sale of the Jay Street property in March 2019, PH&A repaid \$32,000,000 of its debt with 42-50 Jay Street, LLC, resulting in a remaining debt obligation of \$15,000,000. The remaining \$15,000,000 debt is secured by the Long Island City property, which has an appraised fair value in excess of the debt on which it collateralizes.

10. CLIENT AND THIRD-PARTY REVENUE

For the years ended June 30, 2018 and 2017, client and third-party revenue consists approximately of the following:

	<u>2018</u>	<u>2017</u>
Healthcare services	\$ 18,658,000	\$ 19,857,000
Home relief	3,499,000	4,465,000
Aid for Families with Dependent Children funding	1,033,000	3,049,000
Private insurance and client payments	10,556,000	14,813,000
Other client fees	904,000	907,000
Food stamps	728,000	756,000
School lunch program	<u>178,000</u>	<u>237,000</u>
	<u>\$ 35,556,000</u>	<u>\$ 44,084,000</u>

11. NET ASSETS AND NET ASSETS RELEASED FROM RESTRICTIONS

At June 30, 2018 and 2017, PH&A had permanently restricted net assets totaling approximately \$3,517,000. Earnings on permanently restricted net assets are to be used in support of operations or specified program initiatives, as stipulated by the respective donors.

PHOENIX HOUSE AND AFFILIATES
Notes to Consolidated Financial Statements
June 30, 2018 and 2017

At June 30, 2018 and 2017, temporarily restricted net assets are restricted for the following purposes:

	<u>2018</u>	<u>2017</u>
Specified program initiatives	\$ 2,485,000	\$ 2,990,000
Capital initiatives	1,604,000	2,219,000
Endowment earnings, awaiting appropriation for expenditure	<u>334,000</u>	<u>295,000</u>
	<u>\$ 4,423,000</u>	<u>\$ 5,504,000</u>

Net assets restricted for use in capital initiatives relate primarily to PH&A’s electronic health record system and renovations to its Lake Ronkonkoma facility.

Following satisfaction of and in accord with donor-specified use restrictions, during fiscal 2018 and 2017 temporarily restricted net assets totaling approximately \$2,935,000 and \$5,424,000, 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. All not-for-profit organizations formed in New York must apply this law. It was effective for PH&A’s 2011 fiscal year.

PH&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 PH&A in a manner consistent with the standard of prudence prescribed by NYPMIFA. In accordance with NYPMIFA, PH&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 PH&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 PH&A;
- 7) The investment policies of PH&A; and
- 8) Where appropriate, alternatives to spending from donor-restricted endowment funds and the possible effects on PH&A

PHOENIX HOUSE AND AFFILIATES
Notes to Consolidated Financial Statements
June 30, 2018 and 2017

The following tables summarize PH&A's donor-restricted endowment net asset composition by type of fund as of June 30, 2018 and 2017:

	2018		
	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	<u>\$ 334,000</u>	<u>\$ 3,517,000</u>	<u>\$ 3,851,000</u>

	2017		
	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	<u>\$ 295,000</u>	<u>\$ 3,517,000</u>	<u>\$ 3,812,000</u>

The following tables summarize the changes in PH&A's endowment net assets for the years ended June 30, 2018 and 2017:

	2018		
	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	\$ 295,000	\$ 3,517,000	\$ 3,812,000
Interest and dividends	53,000	-	53,000
Appropriation of endowment assets for expenditure	(264,000)	-	(264,000)
Investment gains	250,000	-	250,000
Endowment net assets, end of year	<u>\$ 334,000</u>	<u>\$ 3,517,000</u>	<u>\$ 3,851,000</u>

	2017		
	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	\$ 56,000	\$ 3,992,000	\$ 4,048,000
Re-designation of endowment gift by donor	(76,000)	(475,000)	(551,000)
Interest and dividends	119,000	-	119,000
Appropriation of endowment assets for expenditure	(272,000)	-	(272,000)
Investment gains	468,000	-	468,000
Endowment net assets, end of year	<u>\$ 295,000</u>	<u>\$ 3,517,000</u>	<u>\$ 3,812,000</u>

During fiscal 2017, two donors agreed to re-designate their endowment gifts totaling \$475,000 and the related accumulated earnings therefrom of approximately \$76,000 to help fund renovations at the Riverwalk facility. Accordingly, the \$475,000 of endowment funds, now wholly expendable for capital expenditures, were reclassified to temporarily restricted net assets during the fiscal year ended June 30, 2017 and are reflected as re-designation of permanently restricted contributions by donor on the accompanying 2017 consolidated statement of operations and changes in net assets.

PHOENIX HOUSE AND AFFILIATES
Notes to Consolidated Financial Statements
June 30, 2018 and 2017

12. RETIREMENT PLANS

PH&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 PH&A were 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 to the plan of 3.5% of eligible compensation and a 50% match on participant contributions (maximum match is 2.5%).

Total contributions to the plan by PH&A during fiscal 2018 and 2017 totaled approximately \$1,481,000 and \$1,228,000, respectively, and are recorded to employee benefits and payroll taxes on the accompanying statements of operations and changes in net assets.

PH&A has a 457(b) deferred compensation plan to provide certain employees of PH&A with the benefit of additional tax-deferred retirement savings opportunities. The annual 457(b) deferral limitation for 2018 and 2017 was \$18,500 and \$18,000, respectively. This plan is entirely funded by employee salary deferrals. Plan assets and liabilities pertaining to the 457(b) plan are reported in investments and accrued liabilities in the accompanying consolidated statements of financial position.

13. FUNCTIONAL EXPENSES

PH&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 for the years ended June 30, 2018 and 2017, are as follows:

	<u>2018</u>	<u>2017</u>
Program services		
Residential treatment services	\$ 65,379,709	\$ 70,742,763
Ambulatory treatment services	6,756,745	8,068,550
Healthcare services	4,694,445	7,318,209
Prevention and education services	4,691,974	4,555,024
Supporting services		
Administration and general	29,831,517	25,593,495
Fundraising	<u>1,208,085</u>	<u>1,047,078</u>
Total expenses	<u>\$ 112,562,475</u>	<u>\$ 117,325,119</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 administration and general support activities not directly related to providing rehabilitation services. Fundraising includes the salaries and related expenses of employees involved in fundraising activities.

PHOENIX HOUSE AND AFFILIATES
Notes to Consolidated Financial Statements
June 30, 2018 and 2017

14. COMMITMENTS AND CONTINGENCIES

Lease Commitments

PH&A leases treatment facilities, vehicles and other equipment under various non-cancelable operating leases expiring at various dates through fiscal 2045. Total expense under these leases was approximately \$2,788,000 and \$3,580,000 for the years ended June 30, 2018 and 2017, respectively.

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

2019	\$ 1,767,000
2020	1,179,000
2021	1,053,000
2022	771,000
2023	548,000
Thereafter	<u>1,436,000</u>
	<u>\$ 6,754,000</u>

In addition, PH&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 \$271,000 and \$579,000 for the years ended June 30, 2018 and 2017, respectively.

Litigation

PH&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. PH&A believes that the resolution of these matters will not have a material effect on its consolidated financial statements.

15. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following methods and assumptions are used by PH&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 these 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 PH&A's variable and fixed-rate long-term debt approximates fair value based on rates currently available to PH&A for debt with similar terms, credit quality, and maturities.

Properties held for sale: The reported fair value of PH&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 AND AFFILIATES
Supplemental Information - Consolidating Schedule of Functional Expenses
For the year ended June 30, 2018

	Program Services					Supporting Services				
	Residential	Ambulatory	Healthcare	Prevention	Total	Administration	Fund-	Cost of	Total	Total
	Treatment	Treatment	Services	and Education		and	raising	Direct Benefits		
Services	Services	Services	Services	General	to Donors					
Salaries	\$ 34,419,522	\$ 3,992,089	\$ 2,290,706	\$ 2,887,567	\$ 43,589,884	\$ 12,466,121	\$ 779,474	\$ -	\$ 13,245,595	\$ 56,835,479
Employee benefits and payroll taxes	9,255,715	1,071,018	566,754	808,848	11,702,335	2,702,243	165,247	-	2,867,490	14,569,825
Consulting and contractual services	3,103,472	259,871	570,493	255,065	4,188,901	6,359,169	121,145	-	6,480,314	10,669,215
Resident sustenance	3,487,812	49,978	306,963	6,176	3,850,929	3,335	-	-	3,335	3,854,264
Occupancy costs	3,958,811	695,743	256,893	195,580	5,107,027	1,267,806	37,217	-	1,305,023	6,412,050
Vehicle costs	558,434	15,532	17,820	6,281	598,067	60,553	2,893	-	63,446	661,513
Communications	1,343,838	141,542	70,888	105,304	1,661,572	319,272	15,578	-	334,850	1,996,422
Supplies	1,922,899	147,678	224,815	194,812	2,490,204	176,826	47,298	-	224,124	2,714,328
Insurance	1,777,544	146,615	71,321	82,613	2,078,093	382,688	2,511	-	385,199	2,463,292
Travel	490,230	65,914	55,616	105,623	717,383	319,891	24,474	630	344,995	1,062,378
Interest	361,980	-	7,083	-	369,063	2,464,880	-	-	2,464,880	2,833,943
Miscellaneous	258,823	31,267	21,034	34,134	345,258	1,316,264	10,343	-	1,326,607	1,671,865
Repairs and maintenance	1,923,016	81,815	137,071	9,193	2,151,095	75,197	834	-	76,031	2,227,126
Depreciation and amortization	2,517,613	57,683	96,988	778	2,673,062	1,917,272	1,071	-	1,918,343	4,591,405
Total functional expenses	65,379,709	6,756,745	4,694,445	4,691,974	81,522,873	29,831,517	1,208,085	630	31,040,232	112,563,105
Less: Costs of direct benefits to donors for special events	-	-	-	-	-	-	-	(630)	(630)	(630)
Total expenses reported by function	<u>\$ 65,379,709</u>	<u>\$ 6,756,745</u>	<u>\$ 4,694,445</u>	<u>\$ 4,691,974</u>	<u>\$ 81,522,873</u>	<u>\$ 29,831,517</u>	<u>\$ 1,208,085</u>	<u>\$ -</u>	<u>\$ 31,039,602</u>	<u>\$ 112,562,475</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 AND AFFILIATES
Supplemental Information - Consolidating Schedule of Functional Expenses
For the year ended June 30, 2017

	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	\$ 36,833,751	\$ 4,708,338	\$ 3,474,812	\$ 2,868,230	\$ 47,885,131	\$ 13,659,237	\$ 448,459	\$ -	\$ 14,107,696	\$ 61,992,827
Employee benefits and payroll taxes	9,581,988	1,170,640	797,473	797,053	12,347,154	2,386,609	92,503	-	2,479,112	14,826,266
Consulting and contractual services	3,518,128	557,223	1,255,028	224,367	5,554,746	4,128,806	321,734	-	4,450,540	10,005,286
Resident sustenance	4,035,838	49,468	417,762	7,821	4,510,889	5,046	1,800	1,836	8,682	4,519,571
Occupancy costs	4,799,452	788,456	399,979	180,912	6,168,799	1,247,323	28,396	-	1,275,719	7,444,518
Vehicle costs	637,439	38,412	22,689	7,920	706,460	128,689	-	-	128,689	835,149
Communications	1,460,577	162,063	94,935	102,569	1,820,144	360,515	24,066	-	384,581	2,204,725
Supplies	1,838,651	166,475	285,743	146,363	2,437,232	212,640	53,665	-	266,305	2,703,537
Insurance	1,886,623	192,874	116,179	96,375	2,292,051	502,156	2,110	-	504,266	2,796,317
Travel	481,941	87,642	59,232	89,989	718,804	544,818	35,148	163,903	743,869	1,462,673
Interest	408,531	-	18,305	-	426,836	523,423	-	-	523,423	950,259
Miscellaneous	330,745	21,876	103,622	24,102	480,345	1,192,255	37,119	1,883	1,231,257	1,711,602
Repairs and maintenance	2,115,049	71,231	142,011	8,831	2,337,122	90,341	1,007	-	91,348	2,428,470
Depreciation and amortization	2,814,050	53,852	130,439	492	2,998,833	611,637	1,071	-	612,708	3,611,541
Total functional expenses	70,742,763	8,068,550	7,318,209	4,555,024	90,684,546	25,593,495	1,047,078	167,622	26,808,195	117,492,741
Less: Costs of direct benefits to donors for special events	-	-	-	-	-	-	-	(167,622)	(167,622)	(167,622)
Total expenses reported by function	<u>\$ 70,742,763</u>	<u>\$ 8,068,550</u>	<u>\$ 7,318,209</u>	<u>\$ 4,555,024</u>	<u>\$ 90,684,546</u>	<u>\$ 25,593,495</u>	<u>\$ 1,047,078</u>	<u>\$ -</u>	<u>\$ 26,640,573</u>	<u>\$ 117,325,119</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 AND AFFILIATES
Schedule of Expenditures of Federal and State of Florida Awards (continued)
For the year ended June 30, 2018

Award Recipient	Federal/State Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number	Direct or Pass-Through Grantor Number	Federal Expenditures
Federal Awards	U.S. Department of Health and Human Services ("DHHS"): Substance Abuse and Mental Health Services Administration			
	<i>Substance Abuse Block Grant</i>			
	Passed-through from:			
Phoenix Houses of Los Angeles, Inc.	County of Los Angeles—Department of Public Health	93.959	PH-002025	\$ 1,478,526
Phoenix House Orange County, Inc.	County of Orange—Health Care Agency	93.959	N/A	<u>1,742,739</u>
	Total Phoenix Houses of California, Inc. and Affiliates pass-through awards Substance Abuse Prevention and Treatment ("SAPT") program			<u>3,221,265</u>
			2016-048474-002 SA/TRA	
			2016-048478-002 SA/TRY	
			2016-048488-001 SA/TRF	
			2016-048491-002 SA/TRY	
			2016-048500-002 SA/TRF	
			2016-048519-002 SA/TRY	
			2017-049941-001 SA/TRY LBHA	
			2017-049950-001 SA/TRY LBHA	
			2016-048474-003 SA/TRA	
			2016-048478-003 SA/TRY	
			2016-048481-003 SA/TRA	
			2016-048488-003 SA/TRF	
			2016-048491-003 SA/TRY	
			2016-048500-003 SA/TRF	
			2016-048519-003 SA/TRY	
Phoenix Houses of Texas, Inc.	Texas Department of State Health Services	93.959	2017-049941-002 SA/TRY-LBHA	1,735,565

PHOENIX HOUSE AND AFFILIATES
Schedule of Expenditures of Federal and State of Florida Awards (continued)
For the year ended June 30, 2018

<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>
	<i>SAPT Program—Block Grants for Prevention and Treatment of Substance Abuse (continued)</i>			
	Passed-through from:			
			2016-048018-002 YPS	
			2016-048018-003 YPS	
			2016-048017-002 YPS	
Phoenix Houses of Texas, Inc.	Texas Department of State Health Services	93.959	2016-048017-003 YPS	\$ 502,390
			2016-048211-002 YPI	
Phoenix Houses of Texas, Inc.	Texas Department of State Health Services	93.959	2016-048211-003 YPI	313,373
			2016-048068-002 YPU	
			2016-048068-003 YPU	
			2016-048069-002 YPU	
Phoenix Houses of Texas, Inc.	Texas Department of State Health Services	93.959	2016-048069-003 YPU	628,576
			2016-047903-002 CCP	
Phoenix Houses of Texas, Inc.	Texas Department of State Health Services	93.959	2016-047903-003 CCP	<u>122,181</u>
	Total Phoenix Houses of Texas, Inc. pass-through awards SAPT program			<u>3,302,085</u>
Phoenix Houses of New England, Inc.	State of New Hampshire Department of Health and Human Services, Division of Public Health	93.959	1024152	283,291
Phoenix Houses of New England, Inc.	Rhode Island Department of Behavioral Healthcare, Developmental Disabilities and Hospitals	93.959	3343394	81,515
Phoenix Houses of New England, Inc.	Massachusetts Department of Public Health	93.959	INTF2318MM3300221033	71,716
Phoenix Houses of New England, Inc.	Massachusetts Department of Public Health	93.959	INTF2304M03171125279	87,229
Phoenix Houses of New England, Inc.	Massachusetts Department of Public Health	93.959	INTF2333M03172925032	28,357
Phoenix Houses of New England, Inc.	Massachusetts Department of Public Health	93.959	INTF2333M03172925034	50,685
Phoenix Houses of New England, Inc.	Vermont Office of Alcohol and Drug Abuse Programs	93.959	03420-A18091S	<u>276,704</u>
	Total Phoenix Houses of New England, Inc. pass-through awards SAPT program			<u>879,497</u>

PHOENIX HOUSE AND AFFILIATES
Schedule of Expenditures of Federal and State of Florida Awards (continued)
For the year ended June 30, 2018

Award Recipient	Federal/State Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number	Direct or Pass-Through Grantor Number	Federal Expenditures
	<i>SAPT Program—Block Grants for Prevention and Treatment of Substance Abuse (continued):</i>			
	Passed-through from:			
Phoenix Programs of Florida, Inc.	State of Florida, Department of Children and Families	93.959	CFBHN QB037/QD1A9	\$ <u>272,218</u>
	Total Phoenix Houses of Florida, Inc. pass-through awards SAPT program			<u>272,218</u>
	Passed-through from:			
Phoenix Houses of Long Island, Inc.	New York State Office of Alcoholism and Substance Abuse Services	93.959	C004066	<u>3,478,912</u>
	Total Phoenix Houses of New York, Inc. and Affiliates pass-through awards SAPT program			<u>3,478,912</u>
	Total Block Grants for Prevention and Treatment of Substance Abuse (93.959)			<u>11,153,977</u>
	<i>Comprehensive Community Mental Health Services for Children with Serious Emotional Disturbances</i>			
	Passed-through from:			
Phoenix Houses of Los Angeles, Inc.	Department of Health and Human Services	93.104	N/A	<u>824,933</u>
	Total Comprehensive Community Mental Health Services for Children with Serious Emotional Disturbances (93.104)			<u>824,933</u>
	Total Substance Abuse and Mental Health Services Administration			<u>11,978,910</u>
	Administration for Children and Families			
	<i>Foster Care- Title IV-E</i>			
	Passed-through from:			
Phoenix Houses of Los Angeles, Inc.	County of Los Angeles, Department of Children and Family Services	93.658	AFDC	<u>1,047,332</u>
	Total DHHS Foster Care - Title IV-E (93.658)			<u>1,047,332</u>

PHOENIX HOUSE AND AFFILIATES
Schedule of Expenditures of Federal and State of Florida Awards (continued)
For the year ended June 30, 2018

Award Recipient	Federal/State Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number	Direct or Pass-Through Grantor Number	Federal Expenditures
Administration for Children and Families (continued)				
Healthy Marriage Promotion and Responsible Fatherhood Grants				
Passed-through from:				
Phoenix Houses of New York, Inc.	Department of Human Services Administration for Children and Families	93.086	90FM0110-01-00 90FM0110-02-00	\$ 735,282
Total Healthy Marriage Promotion and Responsible Fatherhood Grants (93.086)				<u>735,282</u>
Total Administration for Children and Families				<u>1,782,614</u>
U.S. Department of Agriculture:				
Food and Nutrition Service				
School Breakfast Program				
Passed-through from:				
Phoenix Houses of Los Angeles, Inc.	California Department of Education	10.553	30-34306-9014887-01	62,095
Phoenix Houses of Texas, Inc.	Texas Department of Agriculture	10.553	N/A	38,448
Total School Breakfast Program (10.553)				<u>100,543</u>
School Lunch Program				
Passed-through from:				
Phoenix Houses of Texas, Inc.	Texas Department of Agriculture	10.555	N/A	75,822
Total School Lunch Program (10.555)				<u>75,822</u>
Total Food and Nutrition Service				<u>176,365</u>
Total U.S. Department of Agriculture				<u>176,365</u>
U.S. Department of Veterans Affairs:				
VA Homeless Providers Grant and Per Diem Program				
Passed-through from:				
Phoenix Houses of Los Angeles, Inc.	Vermont Department of Veterans Affairs	64.024	08-38-VT	41,806
Total VA Homeless Providers Grant and Per Diem Program (64.024)				<u>41,806</u>
Total U.S. Department of Veterans Affairs				<u>41,806</u>
Total Expenditures of Federal Awards				<u>\$ 13,979,695</u>

PHOENIX HOUSE AND AFFILIATES
Schedule of Expenditures of Federal and State of Florida Awards (continued)
For the year ended June 30, 2018

Award Recipient	Federal/State Grantor/Pass-Through Grantor/Program Title	State CSFA Number	Direct or Pass-Through Grantor Number	State Expenditures
State of Florida Awards				
State of Florida Department of Corrections				
Phoenix Programs of Florida, Inc.	Substance Abuse Services	N/A	C2658	\$ 3,428,271
Phoenix Programs of Florida, Inc.	Offender Supervision - Probation and Restitution Centers, and Prison Diversion Program	70.003	C2626; C2904	<u>469,651</u>
Total State of Florida Department of Corrections				<u>3,897,922</u>
State of Florida Office of the State Courts Administrator				
Adult Post-Adjudicatory Drug Court Expansion Program				
Passed-through from:				
Phoenix Programs of Florida, Inc.	Drug Abuse Comprehensive Coordinating Office	N/A	N/A	295,767
Phoenix Programs of Florida, Inc.	Volusia County Drug Court	N/A	07003600	<u>85,272</u>
Total Adult Post-Adjudicatory Drug Court Expansion Program				<u>381,039</u>
Passed-through from:				
Phoenix Programs of Florida, Inc.	Florida Alcohol and Drug Abuse Association	N/A	N/A	<u>57,478</u>
Total Florida Alcohol and Drug Abuse Association				<u>57,478</u>
Total State of Florida Office of the State Courts Administrator				<u>438,517</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>334,155</u>
Total Family Preservation Program				<u>334,155</u>
Total Expenditures of State of Florida Awards				<u>\$ 4,670,594</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 AND AFFILIATES

Notes to the Schedule of Expenditures of Federal and State of Florida Awards

For the year ended June 30, 2018

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 and Affiliates (“PH&A”) for the year ended June 30, 2018, 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 (“Uniform Guidance”) and Section 215.97, Florida Statutes, and Chapter 10.650, Rules of the State of Florida Auditor General.

2. INDIRECT COST RATE

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

3. SUBRECIPIENTS

PH&A did not make any disbursements to subrecipients during the year ended June 30, 2018.

GRANT THORNTON LLP

757 Third Ave., 9th Floor
New York, NY 10017-2013

D +1 212 599 0100

F +1 212 370 4520

S [linkd.in/grantthorntonus](https://www.linkedin.com/company/grantthorntonus)

twitter.com/grantthorntonus

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 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 and Affiliates (“PH&A”), which comprise the consolidated statement of financial position as of June 30, 2018, and the related consolidated statements of activities and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated May 3, 2019.

Internal control over financial reporting

In planning and performing our audit of the consolidated financial statements, we considered PH&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 PH&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 PH&A’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 and therefore, material weaknesses or significant deficiencies may exist that have not been identified. 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. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings and questioned costs as items 2018-001 and 2018-002, that we consider to be significant deficiencies in PH&A's internal control.

Compliance and other matters

As part of obtaining reasonable assurance about whether PH&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 an instance of noncompliance, described in the accompanying schedule of findings and questioned costs as item 2018-002, that is required to be reported under *Government Auditing Standards*.

PH&A's response to findings

PH&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 PH&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 PH&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 PH&A's internal control and compliance. Accordingly, this report is not suitable for any other purpose.

Grant Thornton LLP

New York, New York
May 3, 2019

GRANT THORNTON LLP

757 Third Ave., 9th Floor
New York, NY 10017-2013

D +1 212 599 0100

F +1 212 370 4520

S [linkd.in/grantthorntonus](https://www.linkedin.com/company/grantthornton-us)

twitter.com/grantthorntonus

**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 and Affiliates

Report on compliance for each major federal and State of Florida programs

We have audited the compliance of Phoenix House and Affiliates (“PH&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 its major federal program, 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 PH&A’s major State of Florida program for the year ended June 30, 2018. PH&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 PH&A’s federal and State of Florida programs.

Auditor’s responsibility

Our responsibility is to express an opinion on compliance for each of PH&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), and Section 215.97, Florida Statutes and Chapter 10.650, Rules of the State of Florida Auditor General. Those standards, the Uniform Guidance, and Section 215.97, Florida Statutes and Chapter 10.650, Rules of the State of Florida Auditor General, require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal and State of Florida program occurred. An

audit includes examining, on a test basis, evidence about PH&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 PH&A's compliance.

Opinion on each major federal and State of Florida program

In our opinion, PH&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, 2018.

Report on internal control over compliance

Management of PH&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 PH&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, 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 PH&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 and 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 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. Given these limitations, during our audit we did not identify any deficiencies in PH&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 and Section 215.97, Florida Statutes and Chapter 10.650, Rules of the State of Florida Auditor General. Accordingly, this report is not suitable for any other purpose.

Grant Thornton LLP

New York, New York
July 29, 2019

PHOENIX HOUSE AND AFFILIATES
Schedule of Findings and Questioned Costs
For the year ended June 30, 2018

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? ___ yes X 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:	
<i>U.S. Department of Health and Human Services</i> Block Grants for Prevention and Treatment of Substance Abuse	93.959
State of Florida:	
<i>State of Florida Department of Corrections</i> Substance Abuse Services	N/A

The dollar threshold used to distinguish between type A and type B programs was \$750,000 for federal and State of Florida awards for the year ended June 30, 2018.

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

PHOENIX HOUSE AND AFFILIATES
Schedule of Findings and Questioned Costs
For the year ended June 30, 2018

SECTION II - FINANCIAL STATEMENT FINDINGS

Finding 2018-001:

Phoenix Houses of New England, Inc. and Phoenix Houses of New York, Inc. and Affiliate –
Journal Entry Process – Significant Deficiency

Criteria:

Recipients of federal and state awards are required to have a well-designed system of internal controls, policies and procedures 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 policies and practices with respect to human resources.

Condition, Context, Cause and Effect:

During our testing of journal entries recorded during the year ended June 30, 2018, we noted that for Phoenix Houses of New England, Inc., Phoenix Houses of New York, Inc. and its affiliate, Phoenix Houses of Long Island, Inc., individuals with access to the general ledger system had the ability to post journal entries to the system without a secondary review by another individual occurring first. Further, management was unable to provide evidence of review of journal entries by an individual other than the preparer. It should be noted that while no entries of an irregular or untoward nature were identified as a result of our procedures, the absence of a uniform and sufficiently rigorous review creates the potential for errors to occur and go undetected. In the absence of a documented review of journal entries, we did however note the presence of other mitigating controls, including quarterly reconciliations of significant account balances and budget to actual reporting at the program level.

Questioned Costs:

None noted.

Recommendation:

We recommend that the aforementioned affiliates implement additional controls and approvals over the journal entry posting and approval process by either limiting, by way of system functionality, the ability of individuals to create and post their own entries in the general ledger system or ensuring that documented evidence of independent/supervisory reviews occur and is maintained.

Views of Responsible Officials and Planned Corrective Action:

Please refer to the attached corrective action plan.

Finding 2018-002:

Reporting – Significant Deficiency

Criteria:

Pursuant to Title 2 *U.S. Code of Federal Regulations Part 200*, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (“Uniform Guidance”) and Rules of the Auditor General of the State of Florida, non-federal entities that expend \$750,000 or more of federal or state awards in a year shall have a single audit conducted for that year. Further, pursuant to Subpart F, Section 512 of the Uniform Guidance and Section 10.657 of the Rules of the Auditor General of the State of Florida, the auditee is responsible for

PHOENIX HOUSE AND AFFILIATES
Schedule of Findings and Questioned Costs
For the year ended June 30, 2018

submitting its single audit reporting package, including the auditors' reports, within the earlier of 30 days after receipt of the auditors' reports or nine months after the end of the audit period to the Federal Audit Clearinghouse and Auditor General of the State of Florida, respectively.

Condition, Context, Cause, and Effect:

The single audit of PH&A's federal and State of Florida awards for the year ended June 30, 2018 was not completed within the nine months following the period-end and as a result, PH&A did not submit its single audit reporting package within the required timeframe. As such, PH&A did not comply with the aforementioned regulatory requirements. The delay in the completion of the single audit was primarily caused by the organizational changes undergone by PH&A as described within Note 1 of the footnotes to the accompanying consolidated financial statements.

Recommendation:

We recommend that PH&A ensure that sufficient staffing resources be dedicated to providing documentation relative to the single audit on a timely basis to facilitate the performance of the relevant audit procedures necessary to finalize the single audit report prior to the aforementioned regulatory submission date.

Views of Responsible Officials and Planned Corrective Action:

Please refer to the attached corrective action plan.

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

None noted.

**Corrective Action Plan
For the year ended June 30, 2018**

Finding 2018-001:

Phoenix Houses of New England, Inc. and Phoenix Houses of New York, Inc. and Affiliate –
Journal Entry Process – Significant Deficiency

Condition, Context, Cause and Effect:

During our testing of journal entries recorded during the year ended June 30, 2018, we noted that for Phoenix Houses of New England, Inc., Phoenix Houses of New York, Inc. and its affiliate, Phoenix Houses of Long Island, Inc., individuals with access to the general ledger system had the ability to post journal entries to the system without a secondary review by another individual occurring first. Further, management was unable to provide evidence of review of journal entries by an individual other than the preparer. It should be noted that while no entries of an irregular or untoward nature were identified as a result of our procedures, the absence of a uniform and sufficiently rigorous review creates the potential for errors to occur and go undetected. In the absence of a documented review of journal entries, we did however note the presence of other mitigating controls, including quarterly reconciliations of significant account balances and budget to actual reporting at the program level.

View of Responsible Officials and Planned Corrective Action:

Phoenix House of New England, Inc. and Phoenix House of New York, Inc. and Affiliate will implement procedures over the journal entry posting and approval process to limit the ability of individuals to create and post their own entries through documented evidence of supervisory review and will maintain that evidence on file with copies of the journal entries.

Name of Contact Persons:

Pete Mumma
President & CEO
Phoenix Houses of New England, Inc.
pmumma@phoenixhouse.org
401-331-4250 x3201

Ann-Marie Foster
President & CEO
Phoenix Houses of New York, Inc.
amfoster@phoenixhouse.org
718.222.6673

Proposed Completion Date:

July 22, 2019

Finding 2018-002:

Reporting – Significant Deficiency

Condition, Context, Cause, and Effect:

The single audit of PH&A’s federal and State of Florida awards for the year ended June 30, 2018 was not completed within the nine months following the period-end and as a result, PH&A did not submit its single audit reporting package within the required timeframe. As such, PH&A did not comply with the aforementioned regulatory requirements. The delay in the completion of the single audit was primarily caused by the organizational changes undergone by PH&A as described within Note 1 of the footnotes to the accompanying consolidated financial statements.

View of Responsible Officials and Planned Corrective Action:

Effective April 1, 2019, the board of Phoenix House voted to restructure and to dissolve the sole member of the affiliates and the national corporation. As a result, each regional affiliate became an entity with no members and governed solely by its respective board of directors. As such, each regional entity’s CEO will be responsible for ensuring that adequate resources are assigned to the finance department to manage the single audit process and the auditors and to ensure that reports are filed in a timely manner in accordance with Title 2 *U.S. Code of Federal Regulations Part 200*, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (“Uniform Guidance”) and Rules of the Auditor General of the State of Florida.

Name of Contact Persons:*Maria Alvarez***President & CEO**MAlvarez@PhoenixFL.org

813-881-1000 x 6852

*Shawna Morris***President & CEO**

Phoenix House California

Phoenix House Texas

smorris@phoenixhouseca.org

818-636-4011

*Pete Mumma***President & CEO**

Phoenix Houses of New

England, Inc

pmumma@phoenixhousesne.org

401-331-4250 x3201

Proposed Completion Date:

July 22, 2019