Consolidated Financial Statements

Lutheran Social Services of the South, Inc.

Years ended March 31, 2016 and 2015
with Report of Independent Auditors

Lutheran Social Services of the South, Inc.

Consolidated Financial Statements

For the years ended March 31, 2016 and 2015

Contents

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Report of Independent Auditors

The Board of Directors
Lutheran Social Services of the South, Inc.

We have audited the accompanying consolidated statements of financial position of Lutheran Social Services of the South, Inc. ("LSSS") as of March 31, 2016 and 2015, and the related consolidated statements of activities and cash flows for the years then ended.

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 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. Those standards require that we plan and perform the audits 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 the entity'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 the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the 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 financial position of Lutheran Social Services of the South, Inc. as of March 31, 2016 and 2015, and the changes in its net assets and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Holtzman Partners, LLP

August 8, 2016

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Lutheran Social Services of the South, Inc.
Consolidated Statements of Financial Position
As of March 31, 2016 and 2015

		Donor Restricted			
	Unrestricted	**Temporarily Restricted**	**Permanently Restricted**	**2016 Total**	**2015 Total**
Assets					
Current assets:					
Cash and cash equivalents	**$ 8,714,211**	**$ –**	**$ –**	**$ 8,714,211**	$ 11,127,173
Accounts receivable, net of allowance for uncollectible accounts	**6,702,876**	**–**	**–**	**6,702,876**	4,532,506
Prepaid expenses and other current assets	**343,668**	**–**	**–**	**343,668**	434,324
Marketable securities	**–**	**–**	**–**	**–**	6,172,395
Current portion of assets whose use is limited	**–**	**–**	**–**	**–**	1,760,000
Total current assets	**15,760,755**	**–**	**–**	**15,760,755**	24,026,398
Investments					
Marketable securities, including restricted investments	**12,346,384**	**9,426,097**	**3,858,161**	**25,630,642**	24,470,862
Interest in donor-established trusts	**35,135**	**481,772**	**2,906,251**	**3,423,158**	3,744,278
Total investments	**12,381,519**	**9,907,869**	**6,764,412**	**29,053,800**	28,215,140
Assets whose use is limited:					
Funds held by trustee, less current portion	**–**	**–**	**–**	**–**	7,482,191
Total assets whose use is limited	**–**	**–**	**–**	**–**	7,482,191
Property, buildings, and equipment, net	**23,137,208**	**–**	**–**	**23,137,208**	73,069,195
Deferred financing and marketing costs, net	**–**	**–**	**–**	**–**	2,928,974
Other long-term assets	**988,949**	**9,988**	**–**	**998,937**	75,776
Total assets	**$ 52,268,431**	**$ 9,917,857**	**$ 6,764,412**	**$ 68,950,700**	$135,797,674
Liabilities and net assets					
Current liabilities:					
Accounts payable	**$ 1,221,943**	**$ –**	**$ –**	**$ 1,221,943**	$ 1,815,779
Accrued expenses	**4,212,713**	**–**	**–**	**4,212,713**	4,453,964
Current portion of deferred income	**144,044**	**–**	**–**	**144,044**	657,511
Current portion of long-term debt – Obligated Group	**–**	**–**	**–**	**–**	903,962
Current portion of long-term debt – Other	**–**	**–**	**–**	**–**	966,318
Total current liabilities	**5,578,700**	**–**	**–**	**5,578,700**	8,797,534
Long-term debt – Obligated Group, less current portion	**121,499**	**–**	**–**	**121,499**	19,795,582
Long-term debt – Other, less current portion	**–**	**–**	**–**	**–**	39,007,951
Deferred income	**496,619**	**–**	**–**	**496,619**	4,425,305
Entrance fees and deposits	**9,530,757**	**–**	**–**	**9,530,757**	42,087,062
Total liabilities	**15,727,575**	**–**	**–**	**15,727,575**	114,113,434
Net assets:					
Unrestricted	**36,540,856**	**–**	**–**	**36,540,856**	4,068,306
Temporarily restricted	**–**	**9,917,857**	**–**	**9,917,857**	10,615,554
Permanently restricted	**–**	**–**	**6,764,412**	**6,764,412**	7,000,380
Total net assets	**36,540,856**	**9,917,857**	**6,764,412**	**53,223,125**	21,684,240
Total liabilities and net assets	**$ 52,268,431**	**$ 9,917,857**	**$ 6,764,412**	**$ 68,950,700**	$135,797,674

See accompanying notes to consolidated financial statements.

Lutheran Social Services of the South, Inc.
Consolidated Statement of Activities
For the Year Ended March 31, 2016

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenues, gains and other support:				
Net senior services revenue	**$ 17,682,280**	**$ –**	**$ –**	$ 17,682,280
Therapeutic foster care	**15,830,922**	**–**	**–**	15,830,922
Residential treatment	**25,041,815**	**–**	**–**	25,041,815
Adoption	**780,759**	**–**	**–**	780,759
Education	**2,255,791**	**–**	**–**	2,255,791
Assessment, Marriage, and Family Services	**–**	**–**	**–**	–
Contribution, grants and bequests	**4,979,482**	**2,716,978**	**44,660**	7,741,120
Investment income (loss)	**250,562**	**(613,741)**	**(265,628)**	(628,807)
Revenue (loss) from other sources	**(93,523)**	**–**	**–**	(93,523)
Net assets released from restrictions	**2,759,372**	**(2,744,372)**	**(15,000)**	–
Total revenues, losses, gains and other support	**69,487,460**	**(641,135)**	**(235,968)**	68,610,357
Expenses:				
Salaries and employee benefits	**35,075,379**	**–**	**–**	35,075,379
Assistance to others	**1,595,233**	**–**	**–**	1,595,233
Professional and contract services	**3,428,965**	**56,562**	**–**	3,485,527
Program expenses	**17,190,592**	**–**	**–**	17,190,592
Facility and equipment expense	**6,160,831**	**–**	**–**	6,160,831
Depreciation and amortization	**3,392,633**	**–**	**–**	3,392,633
Interest	**1,893,341**	**–**	**–**	1,893,341
Travel and meeting expense	**931,158**	**–**	**–**	931,158
Other expenses	**999,213**	**–**	**–**	999,213
Total expenses	**70,667,345**	**56,562**	**–**	70,723,907
Loss on early retirement of debt	**(4,249,950)**	**–**	**–**	(4,249,950)
Gain on sale of senior service facilities	**37,902,385**	**–**	**–**	37,902,385
Change in net assets	**32,472,550**	**(697,697)**	**(235,968)**	31,538,885
Net assets at beginning of year	**4,068,306**	**10,615,554**	**7,000,380**	21,684,240
Net assets at end of year	**$ 36,540,856**	**$ 9,917,857**	**$ 6,764,412**	$ 53,223,125

See accompanying notes to consolidated financial statements.

Lutheran Social Services of the South, Inc.
Consolidated Statement of Activities
For the Year Ended March 31, 2015

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenues, gains and other support:				
Net senior services revenue	$ 24,548,891	$ –	$ –	$ 24,548,891
Therapeutic foster care	15,049,071	–	–	15,049,071
Residential treatment	22,848,871	–	–	22,848,871
Adoption	924,104	–	–	924,104
Education	–	–	–	–
Assessment, Marriage, and Family Services	138,185	–	–	138,185
Contribution, grants and bequests	3,637,044	11,155,866	168,213	14,961,123
Investment income	723,254	513,090	2,221	1,238,565
Revenue from other sources	675,615	–	–	675,615
Net assets released from restrictions	5,033,460	(4,945,977)	(87,483)	–
Total revenues, gains and other support	73,578,495	6,722,979	82,951	80,384,425
Expenses:				
Salaries and employee benefits	35,343,721	–	–	35,343,721
Assistance to others	1,523,235	–	–	1,523,235
Professional and contract services	1,843,297	–	–	1,843,297
Program expenses	16,291,945	–	–	16,291,945
Facility and equipment expense	7,949,730	–	–	7,949,730
Depreciation and amortization	4,252,256	–	–	4,252,256
Interest	3,398,908	–	–	3,398,908
Travel and meeting expense	1,146,852	–	–	1,146,852
Other expenses	1,132,833	–	–	1,132,833
Total expenses	72,882,777	–	–	72,882,777
Change in net assets	695,718	6,722,979	82,951	7,501,648
Net assets at beginning of year	3,372,588	3,892,575	6,917,429	14,182,592
Net assets at end of year	$ 4,068,306	$ 10,615,554	$ 7,000,380	$ 21,684,240

See accompanying notes to consolidated financial statements.

Lutheran Social Services of the South, Inc.
Consolidated Statements of Cash Flows

	For the Years Ended March 31, 2016	2015
Operating activities		
Change in net assets	**$31,538,885**	$ 7,501,648
Adjustment to reconcile change in net assets to cash provided by (used in) operating activities:		
Change in donor-established trusts	**(2,022)**	157,996
Amortization of deferred income for life leases	**(761,150)**	(1,151,245)
Amortization of bond premium on debt	**(27,405)**	(47,883)
Amortization of deferred financing costs	**75,173**	122,095
Amortization of capitalized marketing costs	**319,445**	505,772
Depreciation and amortization	**2,997,096**	3,746,482
Net realized and unrealized gains on investments	**1,256,505**	280,602
Net loss on sale of property, buildings, and equipment	**244,386**	27,616
Net gain on divestiture of senior service facilities	**(37,902,385)**	–
Net loss on early retirement of debt	**4,249,950**	–
Changes in operating assets and liabilities:		
Accounts receivable, net	**(2,617,648)**	132,375
Prepaid expenses and other current assets	**139,139**	(29,387)
Other long-term assets	**76,827**	(867)
Accounts payable	**(502,382)**	(629,995)
Accrued expenses	**(2,634,555)**	(188,543)
Deferred income	**49,695**	33,799
Net cash provided by (used in) operating activities	**(3,500,446)**	10,460,465
Investing activities		
Purchase of property, buildings and equipment and other assets, net	**(1,315,785)**	(1,248,156)
Proceeds from sale of property, buildings, and equipment	**39,500**	30,001
Proceeds from divestiture of senior service facilities	**51,450,000**	–
Net purchases of investments	**(430,220)**	(13,311,191)
(Increase) decrease in assets whose use is limited	**13,429,972**	(1,226,038)
Net cash provided by (used in) investing activities	**63,173,467**	(15,755,384)
Financing activities		
Life lease deposits received	**4,472,074**	5,898,255
Life lease deposits refunded	**(4,152,460)**	(3,142,800)
Resident deposits received	**98,805**	118,765
Resident deposits refunded	**(224,965)**	(121,282)
Payments on capital leases	**(7,924)**	(7,109)
Proceeds from long-term debt – Obligated Group	**–**	1,028,313
Payments on long-term debt – Obligated Group	**(20,698,644)**	(1,885,381)
Payments on long-term debt - Other	**(39,366,071)**	(902,446)
Penalty for early retirement of debt	**(2,206,798)**	–
Net cash provided by (used in) financing activities	**(62,085,983)**	986,315
Net change in cash and cash equivalents	**(2,412,962)**	(4,308,604)
Cash and cash equivalents, beginning of year	**11,127,173**	15,435,777
Cash and cash equivalents, end of year	**$ 8,714,211**	$11,127,173
Supplemental disclosure of cash flow information:		
Cash paid for interest	**$ 4,480,281**	$ 3,379,006

See accompanying notes to consolidated financial statements

Lutheran Social Services of the South, Inc.

Notes to Consolidated Financial Statements

As of and for the years ended March 31, 2016 and 2015

1. Organization

Lutheran Social Services of the South is a 135 year-old nonprofit organization with a rich legacy of serving vulnerable children, families and communities throughout Texas through a strong net of programs and services.

During FY 2015, LSSS established a DBA, “Upbring”, in order to reflect its new mission: to break the cycle of child abuse by empowering children, families and communities. Upbring has faith in every future and serves more than 27,000 people annually — providing innovative programs and social services for children and families including foster care, adoption, education, residential treatment, community services, and care and residence for the elderly.

LSSS provides senior services, children services, and disaster relief through the following wholly-owned affiliates: The Village at Gleannloch Farms, Inc. (“VGF”), Lutheran Social Services Disaster Response, Inc., Lutheran Properties, Inc. (“LPI”), Lubbock Lutheran Retirement Corporation, Inc. (“LLRC”), Peace Lake Towers, Inc., and Copperfield Village, Inc. LSSS and affiliates are hereinafter referred to as “LSSS” or the “Organization”.

LPI and LSSS are the “Obligated Group” that is responsible for the repayment of the Series 2004 Revenue Bonds and the Series 2012 Revenue Bonds (Note 5).

LSSS is governed by a Board of Directors where (i) thirteen (13) of the seats on the Board of Directors of the Corporation shall be endorsed by either the appropriate Bishop or District President of the Lutheran jurisdictional units of the Evangelical Lutheran Church in America; the Lutheran Church - Missouri Synod or by the pastor of the congregation of the elected board member; and (ii) three At Large seats shall be elected by the Board of Directors as it is constituted from time to time. The jurisdictional units are known as: Texas District; Texas-Louisiana Gulf Coast Synod; Northern Texas - Northern Louisiana Synod; Southwestern Texas Synod; Southern District; Rocky Mountain District; and Rocky Mountain Synod.

2. Summary of Significant Accounting Policies

Basis of Presentation
The consolidated financial statements of LSSS have been prepared on the accrual basis of accounting. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates
The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates that affect the amounts reported in the consolidated financial statements and accompanying notes. Significant estimates include the allowance for doubtful accounts and accrued professional liability amounts. Actual results could differ from those estimates.

2. Summary of Significant Accounting Policies (continued)

Display of Net Assets by Class
The net assets of LSSS are reported in each of the following classes: (a) unrestricted net assets, (b) temporarily restricted net assets, and (c) permanently restricted net assets. Net assets of the two restricted classes are created only by donor-imposed restrictions on their use. All other net assets, including Board designated, are legally unrestricted and are reported as part of the unrestricted class.

Contributions
LSSS reports gifts of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated asset. A donor restriction expires when a stipulated time restrictions ends or purpose restriction is accomplished. Upon expiration of a donor restriction, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statement of activities as “net assets released from restrictions”.

LSSS recognizes gifts of land and buildings at the fair market value at time of donation, and reports the gifts as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, LSSS reports expirations of donor restrictions when the donated or acquired long-lived assets are placed in service. Donor-restricted contributions whose restrictions are met in the same year are reported as unrestricted support.

Management considers the donation of perpetual trusts to represent an intention to give and, accordingly, recognizes distributions received from the trusts as contribution revenue in the appropriate net asset class according to the trust restrictions. The perpetual trust held by third parties is reported under permanently restricted investments as “Marketable securities” in the accompanying consolidated statements of financial position.

Interest in Donor-Established Trusts
Donors have established trusts for the benefit of LSSS at Lutheran Foundation of the Southwest, Lutheran Foundation of Texas, Lutheran Community Foundation, and Lutheran Church Missouri Synod Foundation (collectively the “Lutheran Foundations”). The assets held by the Lutheran Foundations consist primarily of investments in debt and equity securities.

LSSS receives income and is the principal beneficiary of certain perpetual trusts held by the Lutheran Foundations where the trustee has no discretion regarding the beneficiaries’ participation in the trust. LSSS’s proportionate share of the estimated market value of the trust is reported as an asset and as temporarily restricted contribution revenue at the formation of the trust. Certain perpetual trusts are invested in equity securities with a readily determinable fair value and are measured at fair value (based on quoted market prices) as of the balance sheet date. Changes in LSSS’s proportionate share of the fair market value of the trusts are reported as unrealized gains or losses of donor-established trusts in the appropriate net asset class according to trust restrictions.

2. Summary of Significant Accounting Policies (continued)

LSSS's proportionate share of the market value of the trust, which approximates the net present value of the estimated future cash flows receivable by LSSS, is calculated using the estimated life span of the original donor as determined by actuarial statistics obtained by the trustee, and reported as an asset and as a permanently restricted contribution revenue at the formation of the trust. Annual income distributions from the trust are recognized as investment income in the appropriate net asset class according to the restrictions of the trust.

Deferred Income, Entrance Fees and Deposits

LSSS recognizes revenue for resident services in the period earned, which includes the amortization of entrance fees. Entrance fees are paid by residents as they take occupancy of their reserved units. Of this entrance fee, a portion is non-refundable and is recorded as "Deferred income" and amortized using the straight-line method over the estimated remaining life expectancy of the resident or 5 years, depending on the facility. The remaining life expectancy is re-evaluated annually and amortization periods are prospectively adjusted accordingly. The remaining portion of the entrance fee is refundable to the resident (or appointed estate) upon vacancy from their respective unit, and is recorded as "Entrance fees and deposits," a liability in the accompanying consolidated statements of financial position. This portion of the fee will be refunded once the resident is deceased or moves out of the community, and sufficient entrance fees have been received from the next re-sale and occupancy of any residence of the community.

Discounted Services

LSSS provides certain services to clients on a sliding scale based on the client's ability to pay. Revenues are reported in the consolidated statements of activities based on the net amounts received.

Contributed Services and Facilities

LSSS recorded approximately $192,000 for donated services and donated use of facilities in the consolidated financial statement. LSSS has a substantial number of donors who have contributed significant amounts of time and resources in support of LSSS.

Net Senior Service Revenue

Net senior service revenue was approximately $17.7 million and $24.5 million for the years ended March 31, 2016 and 2015, respectively, and was reported at the estimated net realizable amounts from residents, third-party payers, and others for services rendered. Services provided to Medicare beneficiaries are reimbursed at flat rates as determined by the Medicare fiscal intermediary. Services rendered to Medicaid program beneficiaries are reimbursed at a flat daily rate, as determined by the responsible state agency.

Advertising Costs

Advertising costs are expensed as incurred. Advertising costs for the years ended March 31, 2016 and 2015 were approximately $240,000 and $274,000, respectively, and are included in program expenses in the accompanying statements of activities.

2. Summary of Significant Accounting Policies (continued)

Property Taxes
VGF has applied for and received a conditional exemption from property tax under Section 11.189(d)(19) of the Texas Property Tax Code. In order to comply with the requirements of this exemption, under which at least four percent of the retirement community's combined net resident revenue is provided in charitable care to its residents, VGF has recognized a charity accrual of approximately $792,433 and $506,260 as of March 31, 2016 and 2015, respectively. Charity care is deducted from patient revenue and not included as bad debt expense. VGF calculates charity care provided for property tax exemption requirements based on the price that would have been paid by the patient had the patient paid for the services provided. As of March 31, 2016, LSSS sold VGF and retained the liability to provide charity care for particular residents. See further discussion in Note 3.

Income Taxes
LSSS is exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code.

LSSS accounts for income taxes under Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 740, *Income Taxes*. LSSS evaluates uncertain tax positions, if any exist, under this topic. LSSS accounts for uncertainty of income taxes based on a "more-likely-than-not" threshold for the recognition and de-recognition of tax positions, which includes the accounting for interest and penalties relating to tax positions. LSSS currently does not have any tax positions that it would consider uncertain at March 31, 2016.

Cash and Cash Equivalents
LSSS considers certain liquid asset accounts with an original maturity of three months or less to be cash equivalents.

Fair Value of Financial Instruments
LSSS follows ASC 820, *Fair Value Measurements and Disclosures*. Those provisions relate to the Organization's financial assets and liabilities carried at fair value and the Organization's fair value disclosures related to financial assets and liabilities. ASC 820 defines fair value, expands related disclosure requirements and specifies a hierarchy of valuation techniques based on the nature of the inputs used to develop the fair value measures. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

There are three levels of inputs to fair value measurements - Level 1, meaning the use of quoted prices for identical instruments in active markets; Level 2, meaning the use of quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in markets that are not active or are directly or indirectly observable; and Level 3, meaning the use of unobservable inputs. Observable market data should be used when available.

The fair values of LSSS's financial instruments, including cash and cash equivalents, restricted investments, accounts receivable and payable, prepaid expenses and other current assets, investments, accounts payable, accrued expenses and debt approximate their carrying amount due to the short maturity of these instruments. Investments held by trustee are carried at estimated fair market value based on quoted market prices.

2. Summary of Significant Accounting Policies (continued)

Concentration of Credit Risk
Cash and cash equivalents are placed with high quality financial institutions that from time to time exceed federally insured limits. No losses have been experienced with respect to such balances.

Accounts Receivable, net
Accounts receivable are recorded at invoiced amount, net of contractual adjustments and allowance for doubtful accounts. Additions to the allowance for doubtful accounts are made by means of the provision for doubtful accounts. The amount of the provision for doubtful accounts is based upon management's assessment of historical and expected net collections, business and economic conditions, trends in federal and state governmental health care coverage, and other collection indicators. As of March 31, 2016 and 2015, the allowance for doubtful accounts was approximately $115,000 and $158,000, respectively.

Assets Whose Use Is Limited
Assets whose use is limited are held by an independent trustee under the terms of the various bond indentures. Amounts required for obligations classified as current liabilities are reported as current assets.

Property, Buildings, and Equipment, Net
Property, buildings, and equipment are recorded at cost. Depreciation on property, buildings and equipment is provided on the straight-line method over the estimated useful lives of the assets. The estimated useful lives are approximately 30 years for buildings, 10 years for improvements, and approximately 5 years for equipment. Major additions and betterments are capitalized. Maintenance and repairs which do not materially improve or extend the lives of the respective assets are charged to operating expenses as incurred.

When events, circumstances, or operating results indicate that the carrying values of certain long-lived assets might be impaired, LSSS prepares projections of cash flows expected to result from the use of the assets and their eventual disposition. If the projections indicate that the recorded amounts are not expected to be recoverable, such amounts are reduced to estimated fair value. Fair value may be estimated based upon internal evaluations that include quantitative analysis of revenues and cash flows, reviews of recent sales of similar assets, and independent appraisals. To date, no such impairment charges have been recognized.

Deferred Financing and Marketing Costs
Bond issuance costs are capitalized and amortized over the life of the related bond issue. Amortization of the bond issuance costs was $75,173 and $122,095 as of March 31, 2016 and 2015. Marketing costs are capitalized and amortized over 8 years, which approximates the average remaining actuarial life of the initial residents at entry to VGF. Net capitalized marketing costs were $0 and $631,597 as of March 31, 2016 and 2015, respectively. Amortization of capitalized marketing costs was $319,445 and $505,772 as of March 31, 2016 and 2015, respectively. During 2016, unamortized capitalized marketing costs were written off in conjunction with the sale of VGF. See further discussion of transactions related to these accounts in Note 3.

2. Summary of Significant Accounting Policies (continued)

Medical Malpractice Claims and Similar Liabilities
LSSS accounts for medical malpractice and similar liabilities under ASC Topic 954 by recording estimated professional liability claims gross of anticipated insurance recoveries. LSSS recognizes an insurance receivable at the same time and on the same basis that it recognizes the liability, subject to a need for a valuation allowance for uncollectible amounts.

LSSS purchases medical malpractice insurance covering LSSS and its employed providers, subject to deductibles and to specific and aggregate policy limits. Management believes that LSSS has adequate coverage for any asserted and unasserted claims under applicable insurance. There were no claims made during the years ended March 31, 2016 or 2015.

Charity Care
LSSS accounts for charity care under ASC Topic 945, *Health Care Entities,* which requires an entity in the healthcare industry to use its direct and indirect costs of providing charity care as the measurement basis for charity care disclosures, and to provide additional disclosures of the method used to determine such costs. In order to satisfy the requirements of the property tax exemption disclosed above, LSSS renders services to residents who are financially unable to pay for care. Charity care is deducted from resident revenue and not included as bad debt expense. The estimated cost incurred by LSSS to provide these services to residents who are unable to pay was approximately $292,000 and $238,000 for the years ended March 31, 2016 and 2015, respectively. The estimated cost of these charity care services was determined using direct costs, where applicable, and indirect costs of providing the charity care. Indirect costs were allocated to each residential unit based on either the revenue on the type of unit as a percentage of total revenue or the number of the type of units as a percentage of total units.

Employee Retirement Plan
LSSS sponsors a 403(b) plan (the “Plan”) for the benefit of substantially all employees. LSSS is the administrator of the Plan. Participants may elect to contribute up to the annual maximum set by the Internal Revenue Service.

Risks and Uncertainties
The financial condition of LSSS depends significantly on revenues received from contracts with various departments of the government of the state of Texas (the “State Departments”). Such State Departments are, in turn, dependent almost exclusively on annual or biennial appropriations granted to them by the legislature of the state of Texas. If appropriations to the State Departments are materially reduced or eliminated or appropriations are required to cover more facilities or individuals, the financial condition of LSSS could be materially and adversely affected.

In addition, the revenue received from such contracts with the State Departments is dependent upon (i) LSSS’s fulfilling its obligations under such contracts, (ii) LSSS’s receipt of the appropriate certifications from the required licensing or certifying entity to provide the services required under such contracts, and (iii) LSSS’s ability to renew such contracts with the State Departments. Accounts receivable under these contracts were approximately $2,078,655 and $1,912,000 at March 31, 2016 and 2015, respectively.

2. Summary of Significant Accounting Policies (continued)

LSSS provides health care services primarily to residents in its retirement care facilities. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Management believes that it is in material compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. While no such material regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation, as well as significant regulatory action, including fines, penalties, and exclusion from the Medicare and Medicaid programs.

Subsequent Events

Subsequent events have been evaluated through August 8, 2016, which represents the date the consolidated financial statements were available to be issued**.**

Recent Accounting Pronouncements

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This ASU will supersede the revenue recognition requirements in Topic 605, Revenue Recognition, and most industry-specific guidance, and creates guidance for when revenue should be recognized from the exchange of goods or services. For private companies, this standard is effective for annual reporting periods beginning after December 15, 2018. A nonpublic entity may elect to apply the guidance in this ASU early with certain restrictions. Management is currently evaluating the effect of these provisions on LSSS's consolidated financial position and results of operations.

In August 2014, the FASB issued ASU No. 2014-15*, Presentation of Financial Statements - Going Concern (Subtopic 205-40)*. This ASU defines management's responsibility to evaluate whether there is substantial doubt about an organization's ability to continue as a going concern and to provide related footnote disclosures. Prior to this ASU, U.S. generally accepted accounting principles lacked guidance about management's responsibility to evaluate whether there is substantial doubt about the organization's ability to continue as a going concern or to provide related footnote disclosures and all guidance was included in generally accepted auditing standards ("GAAS"). This guidance is effective for annual periods ending after December 15, 2016. Early adoption is permitted. Management does not expect this provision to have an effect on LSSS's consolidated financial statement presentation.

2. Summary of Significant Accounting Policies (continued)

In January 2015, the FASB issued ASU No. 2015-01, Income Statement - Extraordinary and Unusual Items (Subtopic 225-20): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items. This standard eliminates from U.S. generally accepted accounting principles the concept of extraordinary items. This guidance is effective for annual periods beginning after December 15, 2015. Early adoption is permitted. An entity can elect to apply the guidance prospectively or retrospectively. Management does not expect this provision to have an effect on LSSS's consolidated financial statement presentation.

In April 2015, the FASB issued ASU No. 2015-03, *Interest — Imputation of Interest (Subtopic 835-30) - Simplifying the Presentation of Debt Issuance Costs*. This standard requires debt issuance costs related to a recognized debt liability to be presented in the balance sheet as a direct deduction from the debt liability rather than as an asset. This guidance is effective for annual periods beginning after December 15, 2015. Early adoption is permitted. Upon adoption, an entity must apply the new guidance retrospectively to all prior periods presented in the financial statements. Management is currently evaluating the effect of these provisions on LSSS's consolidated financial position and results of operations.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*. This standard requires lessees to recognize a lease liability and a lease asset for all leases, including operating leases, with a term greater than 12 months on its balance sheet. The standard also expands the required quantitative and qualitative disclosures surrounding leases. This standard is effective for annual periods beginning after December 15, 2019. Early adoption is permitted. This standard will be applied using a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. Management is currently evaluating the effect of these provisions on the LSSS's consolidated financial position and results of operations.

3. Disposal of Assets

On November 17, 2016, the Organization sold the two senior facilities: Village at Gleannloch Farms and Copperfield Village. The facilities and related assets held by VGF, LSSS and LPI were sold to a third party for total cash proceeds of $47,350,000. The assets sold consisted primarily of accounts receivable and property and equipment. The buyer also assumed certain accrued liabilities, refundable deposits, and life lease liabilities. As a part of the sale, LSSS retained its responsibility to provide charity care to VGF residents who were receiving such care as of the sale date. In FY 2016, the Organization recognized a gain on disposal of approximately $36 million, which is reflected in the accompanying consolidated statements of activities.

3. Disposal of Assets (continued)

The following is a summary of the net assets sold as of the closing date of November 17, 2015 and as of March 31, 2015:

	November 17, 2015	March 31, 2015
Accounts receivable	$ 424,370	$ 514,963
Property and equipment, net	44,718,541	45,428,635
Total assets	45,142,911	45,943,598
Accrued liabilities	146,607	128,699
Refundable deposits and life lease liabilities	32,536,552	32,843,625
Total liabilities	32,683,159	32,972,324
Net disposed assets	$ 12,459,752	$ 12,971,274

The financial results for VGF presented in the accompanying consolidated statements of activities consist of the following:

	March 31, 2016	**March 31, 2015**
Revenues	**$ 6,998,001**	$ 12,373,643
Program expenses	**(7,590,647)**	(11,915,156)
Change in net assets	**$ (592,646)**	$ 458,487

Depreciation expense related to the assets disposed in this transaction for the years ended March 31, 2016 and 2015 was approximately $1 million and $2.13 million respectively. Amortization expense was approximately $506,000 and $319,000, respectively.

On August 27, 2015, the Organization sold Wedgewood, a senior service facility. The facility and related assets were held by LLRC and LSSS and were sold to a third party for total proceeds of $5.1 million. Proceeds consisted of $4.1 million in cash and $1 million in notes receivable. The note receivable has a 5 year term, accrues interest at 4.75%, with a balloon payment of $834,801 due October 5, 2020. The note receivable is included in other long term assets on the accompanying consolidated statements of financial position. The assets sold consisted primarily of property and equipment. In FY 2016, the Organization recognized a gain on disposal of approximately $1.9 million, which is reflected in the accompanying consolidated statements of activities.

The following is a summary of the net assets sold as of the closing date of August 27, 2015 and as of March 31, 2015:

	August 27, 2015	March 31, 2015
Property and equipment, net	$ 3,248,250	$ 3,322,982
Net disposed assets	$ 3,248,250	$ 3,322,982

3. Disposal of Assets (continued)

The financial results for Wedgewood presented in the accompanying consolidated statements of activities consist of the following:

	March 31, 2016	March 31, 2015
Revenues	**$ 678,425**	$ 1,654,599
Program expenses	**(954,762)**	(2,076,833)
Change in net assets	**$ (276,337)**	$ (422,234)

Depreciation expense related to the assets disposed in this transaction for the years ended March 31, 2016 and 2015 were approximately $80,000 and $191,000, respectively.

4. Long Term Debt

In August 2015, the Organization redeemed outstanding bonds and mortgage with an aggregate principal balance of approximately $7.5 million. The Organization repaid the outstanding balances with proceeds from the sale of Wedgewood, and the proceeds from the sale of securities that collateralized the mortgage. The Organization recognized a loss on debt retirement of approximately $318,000, which principally represents the unamortized bond discount and unamortized deferred financing costs.

In November 2015, the Organization redeemed outstanding debt, consisting of Series 2004, Series 2006A, and Series 2012 bonds with an outstanding principal balance of approximately $48.8 million. The Organization repaid the outstanding balance with proceeds from the sale of the Village at Gleannloch Farms and Copperfield Village, and proceeds from the sale of securities that collateralized the bonds. The Organization recognized a loss on debt retirement of approximately $3.9 million, which principally represents unamortized deferred financing costs, unamortized bond premium, and interest costs through the bonds initial redemption date of February 2017.

4. Long Term Debt (continued)

Obligated Group

A summary of long-term debt of the Obligated Group is as follows:

	March 31, 2016	March 31, 2015
Health Facilities Development Corporation of Central Texas, Revenue Bonds, Series 2012 (Lutheran Social Services of the South, Inc. Obligated Group Project), original issue $13,160,000. The total issue of $13,160,000 is due in varying amounts annually beginning February 15, 2013 with an interest rate of 3.32% and has a final maturity of February 15, 2035. Beginning in year 2013, varying amounts are subject to mandatory sinking fund redemption.	**$ –**	$ 11,950,000
Health Facilities Development Corporation of Central Texas, Revenue Bonds, Series 2004 (Lutheran Social Services of the South, Inc. Obligated Group Project), original issue $21,360,000. Of this total, $16,860,000 are Series A due in varying amounts annually beginning February 15, 2006 through February 15, 2032, with interest from 3.75% to 6.875%, payable annually. $2,000,000 are Series B due in varying amounts annually beginning February 15, 2032 through February 15, 2035, with interest at 5.25% due annually through 2032, with a variable rate due annually thereafter through 2035. The remaining $2,500,000 are Series C due in varying amounts annually beginning February 15, 2032 through February 15, 2035, with interest at 6.875% due annually through 2032, with a variable rate due annually thereafter through 2035. Beginning in year 2011, varying amounts are subject to mandatory sinking fund redemption.	–	8,720,000
Series 2004 Revenue Bond discount	–	(100,917)
Demand note payable, accruing interest at 3.2%	**121,499**	130,461
	121,499	20,699,544
Less current portion of long-term debt – Obligated Group	**(9,258)**	(903,962)
Long-term debt – Obligated Group, less current portion	**$ 112,241**	$ 19,795,582

4. Long Term Debt (continued)

Maturities of outstanding Obligated Group debt as of March 31, 2016 are as follows:

Years ending March 31,		
2017	**$**	**9,258**
2018		**9,563**
2019		**9,879**
2020		**10,205**
2021 and thereafter		**82,594**
Total maturities	**$**	**121,499**

Long-Term Debt – Other	**March 31,**	
	2016	**2015**
Lubbock Health Facilities Development Corporation, Revenue Bonds, (GNMA Collateralized – Lubbock Lutheran Retirement Corporation Project) Series 2002, original issue $4,500,000. The term bonds are in the amount of $510,000, $700,000, $1,325,000, and $1,965,000, due March 20,, 2020, 2029, and 2037, respectively, with interest of 5.00%, 5.35%, 5.45%, and 5.60%, respectively, payable semiannually. Beginning in the year 2004, varying amounts are subject to mandatory sinking fund redemption. The debt evidenced by the Mortgage Note is a non-recourse obligation of LLRC, an affiliate of LSSS, secured only by the project.	**$** –	$ 3,765,000
Lubbock Lutheran Retirement Corporation – Mortgage Loan	–	3,789,819
Health Facilities Development Corporation of Central Texas, Retirement Facility Revenue Bonds, Series 2006 (The Village at Gleannloch Farms, Inc. Project), original issue $57,075,000: Series 2006A Fixed Rate Bonds $3,535,000 are fixed rate serial bonds due in varying amounts annually beginning February 15, 2012 through February 15, 2016, with interest at 5.25%, payable semi-annually. $31,040,000 are fixed rate term bonds due in the amounts of $250,000, $11,735,000, $600,000 and $18,455,000, due February 15, 2027, 2027, 2037, and 2037, respectively, with interest of 5.00%, 5.50%, 5.15%, and 5.50%, respectively, payable semiannually. Beginning in the year 2017, the fixed rate term bonds are subject to mandatory sinking fund redemption in varying amounts.	–	31,820,000
Series 2006 Revenue Bond premium	–	580,593
Various capital lease obligations	–	18,857
	–	39,974,269
Less current portion of long-term debt – other	–	(966,318)
Long-term debt – other, less current portion	**$** –	$ 39,007,951

4. Long Term Debt (continued)

Lubbock Lutheran Retirement Corporation Debt

Series 2002 Optional Redemption

Outstanding Series 2002 Revenue Bonds maturing on or after March 20, 2013, may be redeemed without premium.

Lubbock Lutheran Retirement Corporation - Mortgage Loan

Lubbock Lutheran Retirement Corporation ("LLRC") owns a building (the Project) whose primary purpose is for housing the elderly, nursing homes, and/or immediate care facilities located in Lubbock, Texas. LLRC acquired the Project through a mortgage loan payable of $4,500,000. Interest accrues at 6.29% with fixed monthly payments of principal and interest totaling $26,541. The mortgage loan commenced April 1, 2002 and matures March 1, 2037. The mortgage loan is insured by the Federal Housing Administration ("FHA"), an organizational unit within HUD, under Section 232 of the National Housing Act of 1934. The mortgage loan is secured on a non-recourse basis pursuant to FHA loan documents. The mortgage loan was fully repaid during the year ended March 31, 2016.

The Village at Gleannloch Farms Debt

Series 2006A Optional and Mandatory Redemption

The Series 2006A bonds maturing on and after February 15, 2027 are subject to optional redemption prior to maturity in whole or in part on February 15, 2017 or on any date thereafter, at a redemption price equal to the principal amount of such bonds to be redeemed, together with accrued interest to the date of redemption. As of March 31, 2016, VGF exercised optional redemption on the Series 2006A bonds.

The Series 2006A bonds are subject to mandatory redemption in whole or in part following the Project completion date at a redemption price equal to the aggregate principal, together with accrued interest to the date of redemption to the extent that surplus construction funds are transferred to the Principal Account of the Bond Fund established pursuant to the bond indenture. For the year ended March 31, 2016 and 2015, VGF repaid $31,820,000 and $745,000, respectively, on the Series 2006A bonds.

5. Restricted Net Assets

Temporarily restricted net assets are available for the following purposes:

	March 31,	
	2016	2015
Adoption services	**$ 186,470**	$ 377,347
Elderly care services	**96,978**	78,843
Children services	**8,813,890**	9,412,881
Disaster relief services	**277,932**	200,055
Services for the poor	**56,742**	104,443
Perpetual trusts held by Lutheran Foundations	**485,845**	441,985
	$ 9,917,857	$ 10,615,554

5. Restricted Net Assets (continued)

Permanently restricted net assets are to be held in investment in perpetuity, the income from which is expendable to support as follows:

	March 31, 2016	March 31, 2015
Adoption services	**$ 55,027**	$ 25,027
Elderly care services	**151,916**	152,439
Children services	**3,410,795**	3,414,616
Clergy care services	**240,423**	240,423
Perpetual trusts held by Lutheran Foundations	**2,906,251**	3,167,875
	$ 6,764,412	$ 7,000,380

Net assets were released from donor restrictions by incurring expenses satisfying the restricted purposes as follows:

	March 31, 2016	March 31, 2015
Program restrictions accomplished:		
Adoption services	**$ 208,578**	$ 17,889
Elderly care services	**7,323**	293,785
Children services	**1,740,561**	2,522,236
Services to the poor	**70,018**	72,317
Administrative	**15,669**	1,510,516
Disaster relief	**717,223**	510,818
Other	**–**	105,899
Total restrictions released	**$ 2,759,372**	$ 5,033,460

6. Property, Buildings, and Equipment, Net

A summary of property, buildings, and equipment is as follows:

	March 31, 2016	March 31, 2015
Land and improvements	**$ 1,392,205**	$ 6,749,744
Buildings and improvements	**43,939,546**	99,969,934
Equipment	**11,219,847**	12,029,900
Construction in progress	**19,000**	55,905
Total	**56,570,598**	118,805,483
Less accumulated depreciation	**(33,433,390)**	(45,736,288)
Property, buildings, and equipment, net	**$ 23,137,208**	$ 73,069,195

6. Property, Buildings, and Equipment, Net (continued)

Depreciation for the years ended March 31, 2016 and 2015 was $2,997,096 and $3,746,482, respectively, and is included in "depreciation and amortization" in the consolidated statement of activities. Estimated costs to complete construction projects in process approximated $1,000 at March 31, 2016. See Note 3 for further description of property, buildings, and equipment transactions for the year ended March 31, 2016.

7. Related Party Transactions

Residents at LSSS residential treatment centers receive education services provided by Trinity Charter Schools ("TCS"), an unconsolidated related party non-profit organization. For the years ended March 31, 2016 and 2015, TCS leased office and classroom space from LSSS for approximately $171,000 and $181,000, respectively.

Trinity Place Apartments ("TPA"), a related party under common control, is a Section 202 Program of Housing for the Elderly or Handicapped in conjunction with the Section 8 Housing Assistance Payments Program. LSSS provides certain administrative support for a management fee, but does not have an economic interest in TPA and TPA is, therefore, not a consolidated entity with LSSS. For the years ended March 31, 2016 and 2015, TPA owed LSSS approximately $11,000 and $41,000, respectively.

8. Investments

Assets Whose Use is Limited
The composition of assets whose use is limited under bond indentures is set forth in the following table. Investments are stated at fair value.

	March 31,	
	2016	**2015**
Cash and short-term investments	**$ –**	$ 1,398,392
U.S. government bonds	–	5,531,719
Corporate bonds	–	2,312,080
Total assets whose use is limited	–	9,242,191
Less current portion of assets whose use is limited	–	(1,760,000)
Assets whose use is limited	**$ –**	$ 7,482,191

Marketable securities, including restricted investments, stated at fair value, include:

	March 31,	
	2016	**2015**
Cash, short-term investments, and mutual funds	**$ 11,473,288**	$ 14,034,288
Domestic and international equity funds	**12,123,555**	12,571,884
U.S. government bonds	–	66,458
Municipal bonds	**234,263**	163,548
Corporate bonds	**460,622**	2,257,751
Corporate stocks	**1,338,914**	1,549,328
	$ 25,630,642	$ 30,643,257

8. Investments (continued)

The following table reflects the fair value measurements for assets whose use is limited and marketable securities, which consist primarily of investments in debt and equity securities. Interest in donor established trust investments, which also consist primarily of debt and equity securities, are held by the Lutheran Foundations (see Note 2).

		Fair Value Measurements at Reporting Date Using		
Description	**March 31, 2016**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Assets Whose Use is Limited	$ –	$ –	$ –	$ –
Marketable Securities	$ 25,630,642	$ 25,630,642	$ –	$ –
Interest in Donor Established Trusts	$ 3,423,158	$ –	$ 3,423,158	$ –

		Fair Value Measurements at Reporting Date Using		
Description	**March 31, 2015**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Assets Whose Use is Limited	$ 9,242,191	–	$ 9,242,191	$ –
Marketable Securities	$ 30,643,257	$ 30,643,257	$ –	$ –
Interest in Donor Established Trusts	$ 3,744,278	$ –	$ 3,744,278	$ –

8. Investments (continued)

Investment income (loss) for assets limited as to use, marketable securities, and interest in donor established trusts consist of the following:

	Years ended March 31, 2016	2015
Investment income (loss):		
Interest and dividend income	**$ 736,492**	$ 823,316
Net realized and unrealized gain (loss)	**(1,365,299)**	415,249
Total investment income (loss)	**$ (628,807)**	$ 1,238,565

To obtain the maximum benefit from its investments, LSSS pools certain available funds and allocates investment income based on the ratio of each pool category's ownership interest in the investment portfolio. Investment income is reported net of related expenses such as custodial fess and advisory costs. The related investment expense for the years ended March 31, 2016 and 2015 was $56,562 and $44,719, respectively.

9. Commitments & Contingencies

LSSS is subject to claims which arise in the ordinary course of its service. In the opinion of management, the amount of ultimate liability with respect to claims will not materially affect the consolidated financial position of LSSS.

LSSS, as an integral part of its operation, has entered into short-term, cancelable lease agreements for equipment and office space in various cities. Additionally, LSSS has entered into non-cancelable lease agreements for equipment and office space in various cities. Lease and maintenance contract expense for all leases, cancelable and non-cancelable, for the years ended March 31, 2016 and 2015 was $1,558,410 and $1,540,436, respectively.

Future minimum lease payments on non-cancelable operating leases are as follows:

Years ending March 31,	
2016	**$ 1,231,096**
2017	**721,772**
2018	**212,158**
2019	**22,922**
2020 and thereafter	**–**
	$ 2,187,948

10. Expenses

A summary of expenses by functional classification is as follows:

	Years ended March 31, 2016	2015
Program services:		
Resident services	**$ 18,142,395**	$ 24,050,159
Children services	**40,697,248**	36,758,866
Services for the poor	**1,220,965**	1,440,402
Disaster relief	**848,227**	1,234,787
Total program services	**60,908,835**	63,484,214
Supporting activities:		
Agency Advancement	**1,778,939**	1,742,338
Management and general	**8,036,133**	7,656,225
Total expenses	**$ 70,723,907**	$ 72,882,777