

**LUTHERAN SOCIAL SERVICES OF
THE SOUTHWEST**

YEAR ENDED JUNE 30, 2015

LUTHERAN SOCIAL SERVICES OF THE SOUTHWEST
YEAR ENDED JUNE 30, 2015

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Independent Auditors' Report

Board of Directors and Management
Lutheran Social Services of the Southwest
Phoenix, Arizona

We have audited the accompanying financial statements of Lutheran Social Services of the Southwest (the Organization), which comprise the statement of financial position as of June 30, 2015, and the related statements of activities, functional expenses and cash flows for the year 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 financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Lutheran Social Services of the Southwest as of June 30, 2015, and the changes in their net assets and their cash flows for the year then ended, in conformity with U.S. generally accepted accounting principles.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued a report dated January 20, 2016, on our consideration of the Organization's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the 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 the Organization's internal control over financial reporting and compliance.

Beach Fleischman PC

Tucson, Arizona
January 20, 2016

LUTHERAN SOCIAL SERVICES OF THE SOUTHWEST

STATEMENT OF FINANCIAL POSITION

JUNE 30, 2015

ASSETS

Current assets:

Cash and cash equivalents	\$ 367,996
Accounts receivable, net of \$31,874 allowance for doubtful accounts	1,684,767
Pledges receivable	39,150
Other receivables	35,799
Prepaid expenses and deposits	<u>101,038</u>

Total current assets 2,228,750

Property and equipment, net	392,296
Pledges receivable, net	108,393
Other assets	<u>74,651</u>

\$ 2,804,090

LIABILITIES AND NET ASSETS

Current liabilities:

Current portion of long-term debt	\$ 46,043
Current portion of capital lease obligations	14,850
Accounts payable	304,980
Accrued expenses	499,440
Deferred revenue	<u>43,793</u>

Total current liabilities 909,106

Note payable, bank	175,000
Long-term debt, net of current portion	105,862
Capital lease obligations, net of current portion	<u>10,828</u>

1,200,796

Commitments and contingencies

Net assets:

Unrestricted:	
Undesignated	1,153,273
Net invested in property and equipment	<u>214,713</u>
	1,367,986
Temporarily restricted	228,214
Permanently restricted	<u>7,094</u>

1,603,294

\$ 2,804,090

LUTHERAN SOCIAL SERVICES OF THE SOUTHWEST

STATEMENT OF ACTIVITIES

YEAR ENDED JUNE 30, 2015

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Revenues and support:				
Contracts with governmental and other agencies	\$ 13,161,694	\$ 6,740	\$ -	\$ 13,168,434
Program fees	286,101	-	-	286,101
Churches	210,632	-	-	210,632
Corporate	28,487	5,000	-	33,487
Individuals	303,830	67,424	-	371,254
Foundations	2,305	-	-	2,305
United Way	31,220	-	-	31,220
Donated goods and services	7,938	-	-	7,938
Other revenue	117,370	-	-	117,370
Net assets released from restrictions	<u>146,112</u>	<u>(146,112)</u>	<u>-</u>	<u>-</u>
	<u>14,295,689</u>	<u>(66,948)</u>	<u>-</u>	<u>14,228,741</u>
Expenses:				
Program services	12,505,951	-	-	12,505,951
Supporting services	<u>1,365,599</u>	<u>-</u>	<u>-</u>	<u>1,365,599</u>
	<u>13,871,550</u>	<u>-</u>	<u>-</u>	<u>13,871,550</u>
Changes in net assets before nonoperating activities	<u>424,139</u>	<u>(66,948)</u>	<u>-</u>	<u>357,191</u>
Nonoperating revenue (expense):				
Other	(1,354)	-	-	(1,354)
Gain on disposal of assets	<u>11,269</u>	<u>-</u>	<u>-</u>	<u>11,269</u>
	<u>9,915</u>	<u>-</u>	<u>-</u>	<u>9,915</u>
Increase (decrease) in net assets	434,054	(66,948)	-	367,106
Net assets, beginning	<u>933,932</u>	<u>295,162</u>	<u>7,094</u>	<u>1,236,188</u>
Net assets, ending	<u>\$ 1,367,986</u>	<u>\$ 228,214</u>	<u>\$ 7,094</u>	<u>\$ 1,603,294</u>

See notes to financial statements.

LUTHERAN SOCIAL SERVICES OF THE SOUTHWEST

STATEMENT OF FUNCTIONAL EXPENSES

YEAR ENDED JUNE 30, 2015

	Program services					Supporting services			
	Aging and Disability Services	Partners in Caring	Children and Family Services	Refugee Focus	Total program services	Management and general	Fundraising/ marketing	Total supporting services	Total expenses
Salaries	\$ 4,583,110	\$ 87,274	\$ 540,931	\$ 1,746,668	\$ 6,957,983	\$ 583,428	\$ 82,898	\$ 666,326	\$ 7,624,309
Employee benefits	654,040	9,776	80,484	281,990	1,026,290	80,655	22,471	103,126	1,129,416
	5,237,150	97,050	621,415	2,028,658	7,984,273	664,083	105,369	769,452	8,753,725
Occupancy	85,313	12,645	42,887	244,883	385,728	101,072	6,848	107,920	493,648
Telephone	43,862	6,778	16,826	26,484	93,950	36,015	2,278	38,293	132,243
Travel	31,895	9,128	31,523	26,221	98,767	17,715	2,231	19,946	118,713
Transportation	42,639	13,687	11,500	106,302	174,128	4,277	3,251	7,528	181,656
Supplies (including in-kind \$7,938)	68,633	8,062	50,558	113,269	240,522	63,492	5,750	69,242	309,764
Contractual	52,896	34,595	597,460	120,080	805,031	264,206	34,824	299,030	1,104,061
Training	2,902	12,000	428	1,950	17,280	123	600	723	18,003
Supportive services	310,628	33,010	164,109	1,957,566	2,465,313	-	-	-	2,465,313
Interest	588	151	630	-	1,369	31,080	203	31,283	32,652
Depreciation and amortization	34,683	6,145	5,356	49,716	95,900	15,789	4,203	19,992	115,892
Bad debts	122,346	-	6,156	15,188	143,690	-	2,190	2,190	145,880
	<u>\$ 6,033,535</u>	<u>\$ 233,251</u>	<u>\$ 1,548,848</u>	<u>\$ 4,690,317</u>	<u>\$ 12,505,951</u>	<u>\$ 1,197,852</u>	<u>\$ 167,747</u>	<u>\$ 1,365,599</u>	<u>\$ 13,871,550</u>

See notes to financial statements.

LUTHERAN SOCIAL SERVICES OF THE SOUTHWEST

STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2015

Cash flows from operating activities:	
Increase in net assets	<u>\$ 367,106</u>
Adjustments to reconcile increase in net assets to net cash used in operating activities:	
Depreciation and amortization	115,892
Bad debts	145,880
Gain on disposal of assets	(11,269)
Changes in operating assets and liabilities:	
Accounts receivable	(300,040)
Pledges receivable	(147,393)
Other receivables	(10,749)
Prepaid expenses and deposits	(21,714)
Other assets	1,400
Accounts payable	(67,523)
Accrued expenses	(8,384)
Deferred revenue	(72,641)
Net adjustments	<u>(376,541)</u>
Net cash used in operating activities	<u>(9,435)</u>
Cash flows from investing activities:	
Purchases of property and equipment	(61,343)
Proceeds from disposal of assets	<u>41,375</u>
Net cash used in investing activities	<u>(19,968)</u>
Cash flows from financing activities:	
Principal payments on long-term debt	(73,041)
Principal payments on capital leases	(2,914)
Borrowings on note payable, bank	525,000
Repayments on note payable, bank	<u>(500,000)</u>
Net cash used in financing activities	<u>(50,955)</u>
Net decrease in cash and cash equivalents	(80,358)
Cash and cash equivalents, beginning	<u>448,354</u>
Cash and cash equivalents, ending	<u><u>\$ 367,996</u></u>

See notes to financial statements.

LUTHERAN SOCIAL SERVICES OF THE SOUTHWEST

NOTES TO FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2015

1. Description of organization and summary of significant accounting policies:

Organization:

Lutheran Social Services of the Southwest (LSS-SW or Organization) is a nonprofit organization committed to providing quality human care services that build and strengthen individuals, families and communities. In pursuit of this goal, the Organization offers a multitude of programs and services. *Aging and Disability Services* and *Refugee Focus* are the Organization's two largest programs. Other programs serve community members by providing employment services, various senior services, comprehensive case management and basic needs assistance, which consist of distributing food boxes and financial assistance.

The Organization uses a variety of methods to fund its many programs. Sources of revenue included contributions from congregations, federal and state contracts, fees for service, and contributions from individuals, foundations, corporations and the United Way.

Estimates:

The preparation of financial statements in conformity with U.S. generally accepted accounting principles (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 reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Financial statement presentation:

The Organization reports information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets and permanently restricted net assets. Resources are reported for accounting purposes in separate classes of net assets based on the existence or absence of donor-imposed restrictions. In the accompanying financial statements, net assets that have similar characteristics are combined into similar categories as follows:

- Unrestricted - Net assets that are not subject to donor-imposed stipulations. Unrestricted net assets may be designated for specific purposes by action of the Board of Directors or may otherwise be limited by contractual agreements with outside parties.
- Temporarily restricted - Net assets whose use by the Organization is subject to donor-imposed stipulations that are fulfilled by actions of the Organization pursuant to those stipulations or that expire through the passage of time.
- Permanently restricted - Net assets that are subject to donor-imposed stipulations that assets be maintained permanently by the Organization. The donors of these assets permit the Organization to use all or part of the investment return of these assets on continuing operations which may be subject to certain restrictions. These have been classified and reported based on the existence or absence of donor-imposed restrictions.

LUTHERAN SOCIAL SERVICES OF THE SOUTHWEST

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2015

1. Description of organization and summary of significant accounting policies (continued):

Revenues and support:

Revenues from governmental and other pass-through agency contracts are reported as exchange transactions based on the contract provisions. Revenues derived from contracts that are based on units of service and fee-for-service are recorded in the period in which the service is provided to eligible recipients. Revenues resulting from cost reimbursement contracts are recorded in the period in which allowable costs are incurred.

Contributions received are recorded as unrestricted, temporarily restricted or permanently restricted support, depending on the existence and/or nature of any donor restrictions. All donor-restricted support is reported as an increase in temporarily or permanently restricted net assets, depending on the nature of the restriction. When a restriction expires (that is, when a stipulated time restriction ends or purpose restriction is accomplished), temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions. Endowment contributions are reported as additions to permanently restricted net assets.

Support arising from donated goods and services is recognized in the financial statements at its fair value. Donated services are recognized when the services received meet one of the following criteria:

- (a) create or enhance nonfinancial assets
- (b) require specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not provided by donation.

Although the Organization utilizes the services of outside volunteers to perform a variety of tasks that assist the Organization, the fair value of all these services may not be reflected in the financial statements because the above criteria are not met.

Program service revenue is recognized when services are provided.

Cash and cash equivalents:

All highly liquid debt instruments purchased with a maturity of three months or less are considered to be cash equivalents.

All cash and cash equivalents are placed with various credit institutions. At times, such amounts may be in excess of the FDIC insurance limits; however, management does not believe they are exposed to any significant credit risk on cash and cash equivalents.

Accounts receivable:

LSS-SW grants unsecured credit under contracts to its customers that are primarily governmental and nonprofit agencies. LSS-SW considers accounts over 30 days to be past due.

LUTHERAN SOCIAL SERVICES OF THE SOUTHWEST

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2015

1. Description of organization and summary of significant accounting policies (continued):

Accounts receivable (continued):

LSS-SW provides an allowance for doubtful accounts based upon prior experience and management's assessment of the collectibility of existing specific accounts. Doubtful accounts are periodically reviewed for collectibility and written off to the allowance when management determines that all reasonable collection efforts were exhausted.

Pledges receivable:

Unconditional pledges receivable are recognized as revenues at their estimated net realizable value in the period received. Pledges receivable that are collectible over future periods are discounted to their net present value. The provision for uncollectible pledges is based on management's estimate of current economic factors, applied as a percentage of gross contribution revenues. Pledges are periodically reviewed for collectibility and written off to the provision at the time of such determination. At June 30, 2015, pledges receivable are considered fully collectible, therefore, no allowance for uncollectible pledges has been provided.

Property, equipment, depreciation and amortization:

Property and equipment are stated at cost except for donated equipment, which is recorded at its fair market value at the date of gift. Property and equipment with a value of greater than or equal to \$5,000 and a useful life of more than one year is capitalized. Property and equipment under capital lease is stated at cost or the assets' net present value of future lease payments at the date of the lease. Depreciation and amortization are calculated using the straight-line method over the following estimated useful lives of the assets:

Furniture, fixtures and equipment	3 - 5 years
Leasehold improvements	3 - 5 years
Software	3 - 5 years
Vehicles	3 - 10 years

Deferred revenue:

Deferred revenue represents funds received from funding received primarily from the Organization's refugee programs. Revenues are recognized in the period when the related expenses are incurred.

Program expense allocations:

Expenses that can be identified with a specific program are charged directly to the program according to their natural expense classification. Costs incurred that share a common purpose are allocated to programs based on their most current negotiated indirect cost rate.

LUTHERAN SOCIAL SERVICES OF THE SOUTHWEST

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2015

1. Description of organization and summary of significant accounting policies (continued):

Income taxes:

The Organization is exempt from income taxes under both federal (Internal Revenue Code Section 501(c)(3)) and Arizona income tax laws, and is classified as other than private foundation. Accordingly, no provision for federal and state income taxes is made. Income from certain activities not directly related to the Organization's tax-exempt purpose, however, may be subject to taxation as unrelated business taxable income (UBTI).

GAAP requires management to perform an evaluation of all tax positions taken or expected to be taken in the course of preparing the Organization's tax returns to determine whether the tax positions meet a "more likely than not" standard of being sustained under examination by the applicable taxing authorities. This evaluation is required to be performed for all open tax years, as defined by the various statutes of limitations, for federal and state purposes.

The Organization is only subject to income taxes on UBTI. As a result, the Organization is required to file informational returns for federal and state purposes and, if it has UBTI, federal and state income tax returns. With limited exceptions, the Organization is no longer subject to tax examination for any years earlier than 2012 for federal and 2011 for state. Management has performed its evaluation of tax positions taken on all open tax returns and has determined that there were no positions taken that do not meet the "more likely than not" standard.

From time to time, the Organization may be subject to penalties and interest assessed by various taxing authorities, which are classified as management and general expenses, if they occur.

Subsequent events:

The Organization's management has evaluated the events that have occurred subsequent to June 30, 2015 through January 20, 2016, the date that the financial statements were available to be issued. Management has no responsibility to update these financial statements for events and circumstances occurring after this date.

2. Pledges receivable:

Pledges receivable in less than one year	\$ 39,150
Pledges receivable in one to five years	125,517
Less unamortized discount to present value	<u>(17,124)</u>
	\$ 147,543
Less current portion	<u>39,150</u>
Noncurrent portion	<u>\$ 108,393</u>

LUTHERAN SOCIAL SERVICES OF THE SOUTHWEST

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2015

3. Property and equipment:

Artwork	\$ 15,000
Equipment	80,781
Leasehold improvements	19,298
Software	49,411
Vehicles	<u>798,788</u>
	963,278
Less accumulated depreciation and amortization	<u>570,982</u>
	<u><u>\$ 392,296</u></u>

4. Note payable, bank:

LSS-SW has a \$500,000 revolving line of credit with Lutheran Church Extension Fund - Missouri Synod, which matures in February 2018. Interest is payable monthly at 4.375% at June 30, 2015. The line is collateralized by substantially all assets of the Organization. At June 30, 2015, the outstanding balance on the line was \$175,000.

5. Accrued expenses:

Payroll and payroll taxes	\$ 356,671
Retirement	23,874
Vacation	78,294
Workers compensation	38,801
Other	<u>1,800</u>
	<u><u>\$ 499,440</u></u>

6. Long-term debt:

Note payable, Central Arizona Special Services, Inc., payable in monthly installments of \$1,148, without interest, through October 2017, unsecured.	\$ 31,006
Notes payable, Nissan Motor Acceptance Corporation, payable in aggregate monthly installments totaling \$4,364, including interest ranging from 0% to 2.99%, expiring at various dates through April 2020, collateralized by vehicles.	<u>120,899</u>
	151,905
Less current portion	<u>46,043</u>
	<u><u>\$ 105,862</u></u>

LUTHERAN SOCIAL SERVICES OF THE SOUTHWEST

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2015

6. Long-term debt (continued):

Future maturities of long-term debt are as follows:

Year ending <u>June 30,</u>	
2016	\$ 46,043
2017	42,785
2018	29,264
2019	25,231
2020	<u>8,582</u>
	<u>\$ 151,905</u>

7. Capital lease obligations:

The Organization leases vehicles and office equipment under various capital lease agreements payable in monthly installments through April 2019. The Organization has recorded asset costs of \$60,713 and accumulated amortization of \$34,699 at June 30, 2015 related to these obligations.

Future minimum annual payments under these capital leases are as follows:

Year ending <u>June 30,</u>	
2016	\$ 17,063
2017	5,983
2018	3,914
2019	<u>2,167</u>
	29,127
Less amounts representing interest	<u>3,449</u>
Present value of net minimum payments under capital leases	25,678
Less current portion	<u>14,850</u>
	<u>\$ 10,828</u>

LUTHERAN SOCIAL SERVICES OF THE SOUTHWEST

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2015

8. Temporarily restricted net assets:

Temporarily restricted net asset activity for the year ended June 30, 2015 is as follows:

	Beginning balance	Contributions/ increases	Releases	Ending balance
Fund development	\$ 8,625	\$ 13,814	\$ (6,709)	\$ 15,730
Refugee and immigration services	188,056	58,917	(110,198)	136,775
Partners in caring	98,481	6,433	(29,205)	75,709
	<u>\$ 295,162</u>	<u>\$ 79,164</u>	<u>\$ (146,112)</u>	<u>\$ 228,214</u>

9. Commitments:

Operating leases:

The Organization leases offices and equipment under noncancelable operating leases expiring at various dates through May 2020. Rent expense for the year ended June 30, 2015 was \$458,507.

Future minimum lease payments under operating leases are as follows:

Year ending June 30,	
2016	\$ 368,593
2017	307,283
2018	198,227
2019	204,616
2020	<u>101,929</u>
	<u>\$ 1,180,648</u>

10. Contingencies:

Funding:

The Organization received a substantial amount (93% in 2015) of its support from governmental and other pass-through agencies. A significant reduction in the level of this support, if it were to occur, would have a material effect on the programs and activities of the Organization. The governmental funding is subject to compliance audits by the respective governmental agencies. Assessments from such audits, if any, are recorded when the amounts of such assessments are reasonably determinable. Additionally, the Organization contracts with various agencies which require compliance of the service contract terms. Management believes that they have recorded all contract liabilities at June 30, 2015.

LUTHERAN SOCIAL SERVICES OF THE SOUTHWEST

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2015

11. Concentrations:

For the year ended June 30, 2015, three agencies comprised 41% of total revenue. At June 30, 2015, four agencies accounted for 55% of accounts receivable.

12. Program matching revenues:

As part of its grant obligations to Lutheran Immigration and Refugee Services, Church World Services and Episcopal Migration Ministries, and the U.S. Department of Health and Human Services, the Organization is required to obtain in-kind and cash matching dollars. The in-kind contributions do not meet the GAAP reporting requirements and, therefore, are not included in the statement of activities. For the year ended June 30, 2015, the Organization's program participants received \$700,376 in total matching contributions.

13. Related party transactions:

The Organization receives contributions from various related party organizations. During the year ended June 30, 2015, the Organization received \$8,604 from the English District of the Lutheran Church Missouri Synod (LCMS) and \$81,152 from the Grand Canyon Synod of the Evangelical Lutheran Church of America (ELCA). The Bishop of the ELCA Synods and the President of the LCMS Synods appoint or recommend some of the Organization's Board of Directors. During the year ended June 30, 2015, the Organization also received contributions from Lutheran congregations in the amount of \$68,227 from the ELCA congregations and \$2,750 from the LCMS congregations.

14. Retirement plan:

LSS-SW has a 401(k) retirement plan for its eligible employees. Eligible employees may make contributions to the 401(k) plan not to exceed specified annual ceiling amounts. The Plan can make discretionary matching contributions approved each year by the Board of Directors. The Organization matching contribution expense was \$12,711 for the year ended June 30, 2015.

15. Statement of cash flows:

Supplemental disclosure of cash flow information:

Cash paid for interest was \$32,652 for the year ended June 30, 2015.

Noncash investing and financing information:

During 2015, the Organization acquired vehicles with debt totaling \$112,242.