

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

Des Plaines, Illinois

CONSOLIDATED FINANCIAL STATEMENTS

Including Independent Auditors' Report

As of and for the Years Ended June 30, 2017 and 2016

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

TABLE OF CONTENTS
As of and for the Years Ended June 30, 2017 and 2016

Independent Auditors' Report	1 - 2
Consolidated Financial Statements	
Consolidated Statements of Financial Position	3 - 4
Consolidated Statements of Activities	5 - 6
Consolidated Statements of Cash Flows	7 - 8
Consolidated Statements of Functional Expenses and Directly Related Program Services Revenue	9 - 12
Notes to Consolidated Financial Statements	13 - 46
Other Independent Auditors' Reports	
Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With <i>Government Auditing Standards</i>	47 - 48
Report on Compliance for the Major Federal Program and Report on Internal Control Over Compliance Required by the Uniform Guidance	49 - 50
Supplementary Information	
Schedule of Expenditures of Federal Awards	51 - 52
Notes to Schedule of Expenditures of Federal Awards	53
Schedule of Findings and Questioned Costs	54 - 55
Summary Schedule of Prior Audit Findings	56

INDEPENDENT AUDITORS' REPORT

Board of Directors
Lutheran Social Services of Illinois
Des Plaines, Illinois

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Lutheran Social Services of Illinois and Subsidiary Corporations (the "Agency"), which comprise the consolidated statements of financial position as of June 30, 2017 and 2016, and the related consolidated statements of activities, cash flows and functional expenses and directly related program services revenue by Illinois Department of Children and Family Services Program 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.

Auditors' 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 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 auditors' 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 consolidated financial position of the Agency as of June 30, 2017 and 2016, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis-of-Matter

As discussed in Note 3 to the consolidated financial statements, management has devised a plan to improve the results of operations. Our opinion is not modified with respect to that matter.

Other Matters

Report on Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying schedule of expenditures of federal awards and supplementary information identified in the table of contents on pages 51 - 56, 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* are presented for purposes of additional analysis and are not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated November 7, 2017 on our consideration of the Agency'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 the Agency'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 the Agency's internal control over financial reporting and compliance.

Baker Tilly Veitchau Krause, LLP

Milwaukee, Wisconsin
November 7, 2017

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
As of June 30, 2017 and 2016

ASSETS	2017	2016
CURRENT ASSETS		
Cash and cash equivalents	\$ 3,290,060	\$ 4,793,836
Accounts receivable, net of allowance for doubtful accounts of \$2,912,824 and \$3,143,019 at June 30, 2017 and 2016, respectively	10,250,129	9,737,871
Current portion of unconditional promises to give, net of allowance for doubtful promises of \$0 at June 30, 2017 and 2016	167,323	817,320
Prepaid expenses and other assets	521,366	224,283
Short-term investments	5,576,888	2,586,899
Short-term investments - pledged as collateral	11,024,527	11,008,004
Assets held for sale	520,157	252,580
Total Current Assets	31,350,450	29,420,793
INVESTMENTS HELD FOR LONG-TERM PURPOSES	2,649,020	2,686,048
PROPERTY AND EQUIPMENT		
Land	4,187,671	4,600,237
Buildings and other improvements	101,945,025	113,839,291
Furniture and equipment	21,776,446	22,803,033
Construction in progress	181,922	258,306
Property and Equipment, at cost	128,091,064	141,500,867
Less allowance for depreciation	(66,520,424)	(69,050,485)
Property and Equipment, net	61,570,640	72,096,837
OTHER ASSETS		
Unconditional promises to give, less current portion above	186,347	286,995
Escrow deposit accounts	7,907,339	6,842,318
Tenant deposits in trust	107,994	115,216
Cash surrender value of life insurance contracts	320,902	301,904
Total Other Assets	8,522,582	7,546,433
TOTAL ASSETS	\$ 104,092,692	\$ 111,750,111

See accompanying notes to consolidated financial statements.

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION (continued)
As of June 30, 2017 and 2016

LIABILITIES AND NET ASSETS (DEFICIT)		
	2017	2016
CURRENT LIABILITIES		
Line of credit	\$ 2,209,000	\$ 8,147,000
Current maturities of long-term debt:		
Mortgages payable	704,481	831,423
Capital lease obligations	77,106	108,231
Accounts payable and other accrued expenses	5,461,523	6,278,634
Cash advances for special purposes	263,636	246,423
Accrued interest payable	16,686	44,789
Accrued salaries and wages	4,498,340	3,453,010
Accrued and withheld taxes	746,406	613,964
Security deposits	4,004	4,004
Residents' special deposits	37,859	9,073
Total Current Liabilities	14,019,041	19,736,551
LONG-TERM LIABILITIES		
Long-term debt, less current maturities above:		
Mortgages payable	14,740,691	16,589,555
Capital lease obligations	52,572	71,122
Accrued interest payable	-	234,331
Deferred grant revenue from capital advance agreements	42,753,558	44,394,006
Deferred grant revenue from assisted living conversion grant agreement	3,963,307	4,143,463
Deferred grant revenue from federal home loan agreements	91,348	104,020
Liability for split interest gift arrangements	673,951	681,670
Liability for pension benefits	13,629,822	16,899,719
Other long-term liabilities	576,599	579,401
Tenant security deposits held in trust	354,475	412,172
Due to HUD - residual receipts	695,470	1,752,555
Total Long-Term Liabilities	77,531,793	85,862,014
Total Liabilities	91,550,834	105,598,565
NET ASSETS (DEFICIT)		
Unrestricted (deficit)	5,778,708	(638,111)
Temporarily restricted by donors	3,934,856	3,961,363
Permanently restricted by donors for endowment	2,828,294	2,828,294
Total Net Assets	12,541,858	6,151,546
TOTAL LIABILITIES AND NET ASSETS	\$ 104,092,692	\$ 111,750,111

See accompanying notes to consolidated financial statements.

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

**CONSOLIDATED STATEMENTS OF ACTIVITIES
For the Year Ended June 30, 2017**

	2017			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
SUPPORT AND REVENUE				
Public Support:				
Lutheran church support	\$ 960,640	\$ -	\$ -	\$ 960,640
United Way	32,687	61,251	-	93,938
Contributions	2,502,401	196,348	-	2,698,749
Bequests	873,883	-	-	873,883
Total Public Support	<u>4,369,611</u>	<u>257,599</u>	<u>-</u>	<u>4,627,210</u>
Other Revenue:				
Fees and grants from government agencies	52,719,529	-	-	52,719,529
Program service fees	16,441,795	-	-	16,441,795
Grant revenue from deferred grant agreements	1,833,276	-	-	1,833,276
Public sales	115,267	-	-	115,267
Rents and investment return	1,177,182	150,852	-	1,328,034
Gain on disposal of property and equipment	3,230,068	-	-	3,230,068
Miscellaneous	693,114	-	-	693,114
Total Other Revenue	<u>76,210,231</u>	<u>150,852</u>	<u>-</u>	<u>76,361,083</u>
Net assets released from restrictions	<u>365,655</u>	<u>(365,655)</u>	<u>-</u>	<u>-</u>
Total Public Support and Revenue	<u>80,945,497</u>	<u>42,796</u>	<u>-</u>	<u>80,988,293</u>
EXPENSES				
Program Services	<u>72,877,551</u>	<u>-</u>	<u>-</u>	<u>72,877,551</u>
Supporting Services:				
Management and general	5,656,168	-	-	5,656,168
Fundraising	1,537,124	-	-	1,537,124
Total Supporting Services	<u>7,193,292</u>	<u>-</u>	<u>-</u>	<u>7,193,292</u>
Total Program and Supporting Services Expense	<u>80,070,843</u>	<u>-</u>	<u>-</u>	<u>80,070,843</u>
CHANGE IN NET ASSETS BEFORE OTHER ITEMS	874,654	42,796	-	917,450
OTHER ITEMS				
Actuarial loss on annuity obligations	-	(69,303)	-	(69,303)
Decrease in unrecognized pension costs	5,542,165	-	-	5,542,165
CHANGE IN NET ASSETS	6,416,819	(26,507)	-	6,390,312
NET ASSETS (DEFICIT) - Beginning of Year	<u>(638,111)</u>	<u>3,961,363</u>	<u>2,828,294</u>	<u>6,151,546</u>
NET ASSETS (DEFICIT) - END OF YEAR	<u>\$ 5,778,708</u>	<u>\$ 3,934,856</u>	<u>\$ 2,828,294</u>	<u>\$ 12,541,858</u>

See accompanying notes to consolidated financial statements.

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

CONSOLIDATED STATEMENTS OF ACTIVITIES (continued)
For the Year Ended June 30, 2016

	2016			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
SUPPORT AND REVENUE				
Public Support:				
Lutheran church support	\$ 695,539	\$ 13,072	\$ -	\$ 708,611
United Way	74,926	43,700	-	118,626
Contributions	3,113,001	645,672	-	3,758,673
Bequests	1,448,811	93,646	-	1,542,457
Total Public Support	<u>5,332,277</u>	<u>796,090</u>	<u>-</u>	<u>6,128,367</u>
Other Revenue:				
Fees and grants from government agencies	59,747,469	-	-	59,747,469
Program service fees	14,583,301	-	-	14,583,301
Grant revenue from deferred grant agreements	1,833,276	-	-	1,833,276
Public sales	224,142	-	-	224,142
Rents and investment return	(260,483)	(245,634)	-	(506,117)
Gain on disposal of property and equipment	902,559	-	-	902,559
Miscellaneous	821,548	-	-	821,548
Total Other Revenue	<u>77,851,812</u>	<u>(245,634)</u>	<u>-</u>	<u>77,606,178</u>
Net assets released from restrictions	<u>357,015</u>	<u>(357,015)</u>	<u>-</u>	<u>-</u>
Total Public Support and Revenue	<u>83,541,104</u>	<u>193,441</u>	<u>-</u>	<u>83,734,545</u>
EXPENSES				
Program Services	<u>81,572,147</u>	<u>-</u>	<u>-</u>	<u>81,572,147</u>
Supporting Services:				
Management and general	6,934,592	-	-	6,934,592
Fundraising	1,832,264	-	-	1,832,264
Total Supporting Services	<u>8,766,856</u>	<u>-</u>	<u>-</u>	<u>8,766,856</u>
Total Program and Supporting Services Expense	<u>90,339,003</u>	<u>-</u>	<u>-</u>	<u>90,339,003</u>
CHANGE IN NET ASSETS BEFORE OTHER ITEMS	(6,797,899)	193,441	-	(6,604,458)
OTHER ITEMS				
Actuarial loss on annuity obligations	-	(34,652)	-	(34,652)
Increase in unrecognized pension costs	<u>(3,683,675)</u>	<u>-</u>	<u>-</u>	<u>(3,683,675)</u>
CHANGE IN NET ASSETS	(10,481,574)	158,789	-	(10,322,785)
NET ASSETS - Beginning of Year	<u>9,843,463</u>	<u>3,802,574</u>	<u>2,828,294</u>	<u>16,474,331</u>
NET ASSETS (DEFICIT) - END OF YEAR	<u>\$ (638,111)</u>	<u>\$ 3,961,363</u>	<u>\$ 2,828,294</u>	<u>\$ 6,151,546</u>

See accompanying notes to consolidated financial statements.

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended June 30, 2017 and 2016

	2017	2016
CASH FLOWS FROM CONTINUING OPERATIONS		
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in Net Assets before Discontinued Operations	\$ 6,390,312	\$(10,322,785)
Adjustments to reconcile change in net assets to net cash flows from operating activities		
Depreciation	4,529,022	4,676,520
Change in value of liability for split interest gift arrangements (including charitable annuity lead trust)	69,303	34,652
Amortization of deferred grant revenue from various agreements	(1,833,276)	(1,833,276)
Recognition of income on split interest gift arrangements	(10,412)	-
Write off of unamortized prepaid bond issuance costs	251,764	-
Amortization of prepaid bond issuance and debt financing costs	13,749	15,247
Gain on disposal of property and equipment	(3,230,068)	(902,559)
Reinvestment of investment income	(155,286)	(137,107)
Net realized and unrealized (gain) loss on investments	(707,164)	1,306,083
Increase in cash surrender value of life insurance	(23,134)	(17,523)
Increase (decrease) in unrecognized pension costs	(5,542,165)	3,683,675
Provision for bad debt	1,087,854	882,020
Provision for deferred taxes	-	2,265
Changes in assets and liabilities:		
Accounts receivable	(1,600,112)	(3,116,376)
Unconditional promises to give	750,645	(593,831)
Other assets	(143,377)	(13,521)
Restricted deposit accounts	7,222	954,719
Accounts payable and other accrued expenses	(809,485)	335,108
Other current liabilities	1,195,668	(808,264)
Pension expense over contributions	2,272,268	1,760,319
Other long-term liabilities	(44,873)	42,693
Due to HUD - residual receipts	(1,057,085)	(686,294)
Net Cash Flows from Operating Activities	1,411,370	(4,738,235)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property and equipment	(2,187,802)	(2,092,176)
Proceeds from disposal of property and equipment	3,633,459	1,582,801
Purchases of investments	(2,308,000)	(18,118,305)
Proceeds from sales of investments	192,663	23,309,161
Proceeds from surrendering life insurance policies	4,136	31,196
Net withdrawals from residual receipts, replacement reserve, and minimum capital investment	1,365,587	892,416
Net transfers to discontinued operations	-	(516,330)
Net Cash Flows from Investing Activities	700,043	5,088,763

See accompanying notes to consolidated financial statements.

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)
Years Ended June 30, 2017 and 2016

	2017	2016
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from mortgage loan	\$ 3,393,814	\$ 2,300,000
Proceeds from split interest gift arrangements	33,303	121,972
Refund of resident's equity in apartments	-	(52,800)
Payments on split interest gift arrangements	(91,610)	(92,360)
Repayment of other debt	(981,166)	(785,991)
Net draws on (repayments under) line of credit	(5,938,000)	1,488,000
Payment of debt financing costs	(31,530)	-
Net Cash Flows from Financing Activities	(3,615,189)	2,978,821
NET CHANGE IN CASH AND CASH EQUIVALENTS FROM CONTINUING OPERATIONS	(1,503,776)	3,329,349
CASH FLOWS FROM DISCONTINUED OPERATIONS (See Note 2)		
Net Cash Flows from Operating Activities	-	(517,540)
Net Cash Flows from Investing Activities	-	10
Net Cash Flows from Financing Activities	-	516,330
Net Change in Cash and Cash Equivalents from Discontinued Operations	-	(1,200)
NET CHANGE IN CASH AND CASH EQUIVALENTS	(1,503,776)	3,328,149
CASH AND CASH EQUIVALENTS - Continuing Operations, Beginning of Year	4,793,836	1,464,487
CASH AND CASH EQUIVALENTS - Discontinued Operations, Beginning of Year	-	1,200
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	4,793,836	1,465,687
CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 3,290,060	\$ 4,793,836
 Supplemental cash flow disclosures		
Cash paid for interest	\$ 650,399	\$ 745,201
 Noncash investing and financing activities		
Note payable, accrued interest and mortgage payable refinanced with mortgage payable	\$ 2,292,381	\$ -
Property and equipment purchases financed by capital leases, capital advances and accounts payable	\$ 60,014	\$ 67,640
Prepaid expenses financed with mortgage payable	\$ 153,706	\$ -
Escrow deposits transferred with refinance of mortgage payable, net	\$ 2,430,608	\$ -
Proceeds from sale used to settle mortgage payable	\$ 7,506,383	\$ -
Loan costs financed with mortgage payable	\$ 218,651	\$ -

See accompanying notes to consolidated financial statements.

LUTHERAN SOCIAL SERVICES OF ILLINOIS AND SUBSIDIARY CORPORATIONS

CONSOLIDATED STATEMENTS OF FUNCTIONAL EXPENSES AND DIRECTLY RELATED PROGRAM SERVICES REVENUE For the Year Ended June 30, 2017

	2017							Subtotal Program Services
	PROGRAM SERVICES							
	Behavioral Health Services	Children's Community Services	Senior Community Services	Housing Services	Other Operating	Matins, Inc.	Vesper Mgmt Corporation	
FUNCTIONAL EXPENSES								
Salaries	\$ 11,765,220	\$ 16,097,533	\$ 413,109	\$ 4,930,653	\$ -	\$ -	\$ -	\$ 33,206,515
Employee health and retirement benefits, payroll taxes, etc.	<u>3,220,790</u>	<u>4,635,765</u>	<u>84,833</u>	<u>1,685,588</u>	-	-	-	<u>9,626,976</u>
Total salaries and related expenses	14,986,010	20,733,298	497,942	6,616,241	-	-	-	42,833,491
Professional fees and contract service payments	1,168,531	7,480,653	3,233	419,088	-	150	201,203	9,272,858
Supplies	654,112	282,828	2,640	421,863	-	-	9,688	1,371,131
Communications	344,453	409,479	5,731	467,708	-	-	8,641	1,236,012
Occupancy	1,102,163	2,142,529	6,634	4,008,719	-	-	502,330	7,762,375
Advertising and printing	35,494	48,916	474	151,175	-	-	-	236,059
Local transportation	383,661	1,570,389	27,652	120,745	-	-	-	2,102,447
Meetings, seminars and education	202,182	18,593	1,208	10,583	-	-	-	232,566
Specific assistance to individuals	41,924	368,541	-	5,365	-	-	-	415,830
Elderly and congregate expenses	-	-	-	128,278	-	-	-	128,278
Equipment rental and maintenance	279,047	186,890	10,310	51,803	-	-	-	528,050
Miscellaneous and other operating	252,850	40,807	3,196	1,486,045	6,291	15	15	1,789,219
Interest expense	45,621	17,419	6,604	587,902	-	-	79,939	737,485
Total functional expenses	<u>19,496,048</u>	<u>33,300,342</u>	<u>565,624</u>	<u>14,475,515</u>	<u>6,291</u>	<u>165</u>	<u>801,816</u>	<u>68,645,801</u>
Depreciation	409,982	95,622	26,036	3,168,910	-	-	531,200	4,231,750
Total Program and Supporting Services Expense	<u>\$ 19,906,030</u>	<u>\$ 33,395,964</u>	<u>\$ 591,660</u>	<u>\$ 17,644,425</u>	<u>\$ 6,291</u>	<u>\$ 165</u>	<u>\$ 1,333,016</u>	<u>\$ 72,877,551</u>
DIRECTLY RELATED PROGRAM SERVICES REVENUE								
Fees and grants from governmental agencies	\$ 11,261,866	\$ 32,737,636	\$ 194,372	\$ 8,525,655	\$ -	\$ -	\$ -	\$ 52,719,529
Program service fees	7,643,722	346,585	330,459	8,121,029	-	-	-	16,441,795
Grant revenue from deferred grant agreements	-	-	-	1,833,276	-	-	-	1,833,276
Public sales	-	48,975	-	36,573	-	-	-	85,548
Rents and investment return	21,532	27,204	3,150	295,944	40,766	-	82,980	471,576
Gain (loss) on disposal of property and equipment	502,038	14,622	-	2,712,151	-	-	(3,143)	3,225,668
Miscellaneous	<u>371,719</u>	<u>24,654</u>	<u>120</u>	<u>219,202</u>	<u>19,744</u>	<u>-</u>	<u>(534)</u>	<u>634,905</u>
Total Directly Related Program Services Revenue	<u>\$ 19,800,877</u>	<u>\$ 33,199,676</u>	<u>\$ 528,101</u>	<u>\$ 21,743,830</u>	<u>\$ 60,510</u>	<u>\$ -</u>	<u>\$ 79,303</u>	<u>\$ 75,412,297</u>

See accompanying notes to consolidated financial statements.

LUTHERAN SOCIAL SERVICES OF ILLINOIS AND SUBSIDIARY CORPORATIONS

CONSOLIDATED STATEMENTS OF FUNCTIONAL EXPENSES AND DIRECTLY RELATED PROGRAM SERVICES REVENUE (continued)
For the Year Ended June 30, 2017

	2017				
	SUPPORTING SERVICES				Total
	Management and General	Resource Development	The Cornerstone Foundation, Inc.	Subtotal Fundraising	
FUNCTIONAL EXPENSES					
Salaries	\$ 2,688,475	\$ 906,034	\$ -	\$ 906,034	\$ 36,801,024
Employee health and retirement benefits, payroll taxes, etc.	850,694	227,165	-	227,165	10,704,835
Total salaries and related expenses	<u>3,539,169</u>	<u>1,133,199</u>	-	1,133,199	47,505,859
Professional fees and contract service payments	695,316	18,887	43,901	62,788	10,030,962
Supplies	37,138	107,327	175	107,502	1,515,771
Communications	113,128	10,469	2,200	12,669	1,361,809
Occupancy	329,132	4,065	-	4,065	8,095,572
Advertising and printing	24,045	83,506	10,270	93,776	353,880
Local transportation	54,004	25,014	316	25,330	2,181,781
Meetings, seminars and education	44,257	1,478	26,655	28,133	304,956
Specific assistance to individuals	-	-	-	-	415,830
Elderly and congregate expenses	-	-	-	-	128,278
Equipment rental and maintenance	242,691	1,803	-	1,803	772,544
Miscellaneous and other operating	226,900	55,396	8,151	63,547	2,079,666
Interest expense	57,428	-	-	-	794,913
Total functional expenses	<u>5,363,208</u>	<u>1,441,144</u>	<u>91,668</u>	<u>1,532,812</u>	<u>75,541,821</u>
Depreciation	292,960	4,312	-	4,312	4,529,022
Total Program and Supporting Services Expenses	<u>\$ 5,656,168</u>	<u>\$ 1,445,456</u>	<u>\$ 91,668</u>	<u>\$ 1,537,124</u>	<u>\$ 80,070,843</u>
DIRECTLY RELATED PROGRAM SERVICES REVENUE					
Fees and grants from governmental agencies	\$ -	\$ -	\$ -	\$ -	\$ 52,719,529
Program service fees	-	-	-	-	16,441,795
Grant revenue from deferred grant agreements	-	-	-	-	1,833,276
Public sales	-	29,719	-	29,719	115,267
Rents and investment return	3,459	-	852,999	852,999	1,328,034
Gain on disposal of property and equipment	4,400	-	-	-	3,230,068
Miscellaneous	54,059	4,150	-	4,150	693,114
Total Directly Related Program Services Revenue	<u>\$ 61,918</u>	<u>\$ 33,869</u>	<u>\$ 852,999</u>	<u>\$ 886,868</u>	<u>\$ 76,361,083</u>

See accompanying notes to consolidated financial statements.

LUTHERAN SOCIAL SERVICES OF ILLINOIS AND SUBSIDIARY CORPORATIONS

CONSOLIDATED STATEMENTS OF FUNCTIONAL EXPENSES AND DIRECTLY RELATED PROGRAM SERVICES REVENUE (continued)
For the Year Ended June 30, 2016

	2016							Subtotal Program Services
	PROGRAM SERVICES							
	Behavioral Health Services	Children's Community Services	Senior Community Services	Housing Services	Other Operating	Matins. Inc.	Vesper Mgmt Corporation	
FUNCTIONAL EXPENSES								
Salaries	\$ 11,960,857	\$ 15,467,723	\$ 5,867,006	\$ 4,917,931	\$ -	\$ -	\$ -	\$ 38,213,517
Employee health and retirement benefits, payroll taxes, etc.	<u>3,396,521</u>	<u>5,215,881</u>	<u>1,547,163</u>	<u>1,753,661</u>	-	-	-	<u>11,913,226</u>
Total salaries and related expenses	15,357,378	20,683,604	7,414,169	6,671,592	-	-	-	50,126,743
Professional fees and contract service payments	1,116,809	7,651,443	11,105	497,046	-	150	167,288	9,443,841
Supplies	716,002	248,582	107,434	402,104	-	-	4,365	1,478,487
Communications	300,494	384,719	60,099	435,215	-	-	9,145	1,189,672
Occupancy	1,191,771	1,999,408	353,536	4,373,303	-	-	586,343	8,504,361
Advertising and printing	7,088	86,747	36,265	122,226	-	-	188	252,514
Local transportation	312,380	1,456,659	236,466	141,864	-	-	-	2,147,369
Meetings, seminars and education	179,742	12,956	16,317	22,346	-	-	-	231,361
Specific assistance to individuals	40,843	454,302	5,844	11,283	-	-	-	512,272
Elderly and congregate expenses	-	-	-	143,472	-	-	-	143,472
Equipment rental and maintenance	248,363	150,833	57,055	58,092	-	-	-	514,343
Miscellaneous and other operating	406,133	34,434	21,022	1,395,794	6,515	-	2,860	1,866,758
Interest expense	40,078	24,169	18,973	694,034	-	-	13,213	790,467
Total functional expenses	<u>19,917,081</u>	<u>33,187,856</u>	<u>8,338,285</u>	<u>14,968,371</u>	<u>6,515</u>	<u>150</u>	<u>783,402</u>	<u>77,201,660</u>
Depreciation	411,108	62,803	73,516	3,226,571	-	-	596,489	4,370,487
Total Program and Supporting Services Expenses	<u>\$ 20,328,189</u>	<u>\$ 33,250,659</u>	<u>\$ 8,411,801</u>	<u>\$ 18,194,942</u>	<u>\$ 6,515</u>	<u>\$ 150</u>	<u>\$ 1,379,891</u>	<u>\$ 81,572,147</u>
DIRECTLY RELATED PROGRAM SERVICES REVENUE								
Fees and grants from governmental agencies	\$ 12,123,306	\$ 32,417,158	\$ 6,518,592	\$ 8,688,413	\$ -	\$ -	\$ -	\$ 59,747,469
Program service fees	5,406,702	133,074	1,531,350	7,512,175	-	-	-	14,583,301
Grant revenue from deferred grant agreements	-	-	-	1,833,276	-	-	-	1,833,276
Public sales	-	141,797	-	48,924	-	-	-	190,721
Rents and investment return	6,000	22,395	5,018	257,045	9,659	1	338,586	638,704
Gain (loss) on disposal of property and equipment	(4,352)	39,442	(31,323)	940,433	-	-	(41,641)	902,559
Miscellaneous	<u>83,349</u>	<u>522,481</u>	<u>778</u>	<u>186,025</u>	<u>-</u>	<u>-</u>	<u>90</u>	<u>792,723</u>
Total Directly Related Program Services Revenue	<u>\$ 17,615,005</u>	<u>\$ 33,276,347</u>	<u>\$ 8,024,415</u>	<u>\$ 19,466,291</u>	<u>\$ 9,659</u>	<u>\$ 1</u>	<u>\$ 297,035</u>	<u>\$ 78,688,753</u>

See accompanying notes to consolidated financial statements.

LUTHERAN SOCIAL SERVICES OF ILLINOIS AND SUBSIDIARY CORPORATIONS

CONSOLIDATED STATEMENTS OF FUNCTIONAL EXPENSES AND DIRECTLY RELATED PROGRAM SERVICES REVENUE (continued)
For the Year Ended June 30, 2016

	2016				Total
	SUPPORTING SERVICES				
	Management and General	Resource Development	The Cornerstone Foundation, Inc.	Subtotal Fundraising	
FUNCTIONAL EXPENSES					
Salaries	\$ 3,454,679	\$ 990,949	\$ -	\$ 990,949	\$ 42,659,145
Employee health and retirement benefits, payroll taxes, etc	1,019,571	264,066	-	264,066	13,196,863
Total salaries and related expenses	<u>4,474,250</u>	<u>1,255,015</u>	-	1,255,015	55,856,008
Professional fees and contract service payments	966,917	137,975	47,461	185,436	10,596,194
Supplies	1,413	91,633	334	91,967	1,571,867
Communications	168,209	12,278	2,268	14,546	1,372,427
Occupancy	287,162	15,536	-	15,536	8,807,059
Advertising and printing	158,454	64,340	33	64,373	475,341
Local transportation	56,589	25,182	129	25,311	2,229,269
Meetings, seminars and education	57,620	24,431	13,735	38,166	327,147
Specific assistance to individuals	-	-	-	-	512,272
Elderly and congregate expenses	-	-	-	-	143,472
Equipment rental and maintenance	219,903	3,954	-	3,954	738,200
Miscellaneous and other operating	210,236	126,842	5,890	132,732	2,209,726
Interest	33,034	-	-	-	823,501
Total functional expenses	<u>6,633,787</u>	<u>1,757,186</u>	<u>69,850</u>	<u>1,827,036</u>	<u>85,662,483</u>
Depreciation	300,805	5,228	-	5,228	4,676,520
Total Program and Supporting Services Expenses	<u>\$ 6,934,592</u>	<u>\$ 1,762,414</u>	<u>\$ 69,850</u>	<u>\$ 1,832,264</u>	<u>\$ 90,339,003</u>
DIRECTLY RELATED PROGRAM SERVICES REVENUE					
Fees and grants from governmental agencies	\$ -	\$ -	\$ -	\$ -	\$ 59,747,469
Program service fees	-	-	-	-	14,583,301
Grant revenue from deferred grant agreements	-	-	-	-	1,833,276
Public sales	-	33,421	-	33,421	224,142
Rents and investment return	3,959	-	(1,148,780)	(1,148,780)	(506,117)
Gain (loss) on disposal of property and equipment	-	-	-	-	902,559
Miscellaneous	28,825	-	-	-	821,548
Total Directly Related Program Services Revenue	<u>\$ 32,784</u>	<u>\$ 33,421</u>	<u>\$ (1,148,780)</u>	<u>\$ (1,115,359)</u>	<u>\$ 77,606,178</u>

See accompanying notes to consolidated financial statements.

LUTHERAN SOCIAL SERVICES OF ILLINOIS AND SUBSIDIARY CORPORATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended June 30, 2017 and 2016

NOTE 1 - Summary of Significant Accounting Policies

Nature of Activities

Lutheran Social Services of Illinois ("LSSI"), including the subsidiary corporations included herein (the "Agency"), is a multi-functional social service agency which is the social ministry expression of the three Illinois Synods of the Evangelical Lutheran Church in America. It is a corporation organized under the laws of the State of Illinois pursuant to the provisions of the "General Not-For-Profit Corporation Act." It is exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code. The Agency qualifies for the charitable contribution deduction under Section 170(b)(1)(A) and is not a private foundation under Section 509(a)(2). The Agency receives a significant portion of its operating funds from public support, fees and grants from government agencies and program service fees. The Agency's fiscal year ends on June 30. Significant accounting policies followed by the Agency are presented below.

In accordance with authoritative accounting guidance related to reporting of related entities by not-for-profit organizations, twenty-two (22) affiliated not-for-profit corporations incorporated under the Illinois "General Not-For-Profit Corporation Act" are included as subsidiaries in the consolidated financial statements. These corporations are considered subsidiary corporations because Lutheran Social Services of Illinois has control over and an economic interest in these corporations. In addition, LSSI Rockford Property, Inc., which is a for-profit subsidiary, is also consolidated as the Agency owns 100 percent of that company. These subsidiary corporations are:

- Assisi Homes-Downer Place, Inc.
- Aurora Senior Housing, Inc.
- Batavia Council on Aging, Inc.
- The Cornerstone Foundation, Inc. ("Foundation")
- Deer Creek Manor, Inc.
- Dekalb Housing for the Handicapped, Inc.
- Forsberg Christian Retirement Center, Inc. ("Forsberg")*
- Freeport Senior Housing, Inc.
- Freeport Senior Housing II, Inc.
- Fox Hill Senior Housing, Inc.
- LSSI Rockford Property, Inc.
- Luther Center, Inc. **
- Matins, Inc.
- Northwest Chicago Group Homes, Inc.
- Our Savior's Senior Housing
- Rochelle Senior Housing, Inc.
- Rolling Meadows Senior Living, Inc.
- Salem Village III, Inc.
- Spring Ridge Housing for Seniors, Inc.
- Tabor Lutheran Senior Housing, Inc.
- Vesper Management Corporation
- Victorian Woods Senior Living, Inc.

*In 2016, the building that Forsberg operated from was sold and Forsberg did not have any activity after transferring the net proceeds to the Agency.

** In April 2017, the building Luther Center, Inc. operated was sold.

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended June 30, 2017 and 2016

NOTE 1 - Summary of Significant Accounting Policies (cont.)

Nature of Activities (cont.)

Services that the Agency provides include:

Behavioral Health Services: counseling, mental health and crisis intervention, drug and alcohol treatment for youth and adults, support and housing for adults with developmental disabilities, and services for formerly incarcerated individuals.

Children's Community Services:

Child Care Services: child care and Head Start programs designed to develop students' social skills and school readiness.

Foster Care Services: foster care placement and case management for children who have been removed from their birth families due to abuse and/or neglect, to achieve permanency through reunification with families or through adoption.

Senior Community and Housing Services: Non-medical assistance to older adults in their homes, and affordable housing for older adults and people over the age of 18 with disabilities.

Consolidated Financial Statement Presentation

The accompanying consolidated financial statements include the accounts of the Agency. All significant transactions among these corporations have been eliminated.

Basis of Accounting

The consolidated financial statements have been prepared using the accrual basis of accounting.

Cash and Cash Equivalents

The Agency considers all liquid investments with a maturity of three months or less when purchased to be cash and cash equivalents.

Receivables

Accounts receivable are uncollateralized funding source obligations, which generally are payable within 30 days from the invoice or billing date. Accounts receivable are stated at the invoice amount.

Payments of accounts receivable are applied to the specific invoices identified on the funding source's remittance advice or, if unspecified, to the earliest unpaid invoices.

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended June 30, 2017 and 2016

NOTE 1 - Summary of Significant Accounting Policies (cont.)

Receivables (cont.)

The carrying amount of accounts receivable is reduced by a valuation allowance that reflects management's best estimate of amounts that will not be collected. The allowance for doubtful accounts is based on management's assessment of the collectibility of specific funding source accounts and the aging of accounts receivable. If actual write-offs are higher than the historical experience, management's estimates of the recoverability of amounts due to the Agency could be adversely affected. All accounts or portions thereof deemed to be uncollectible or require an excessive collection cost are written off to the allowance for doubtful accounts.

Unconditional Promises to Give

Unconditional promises to give are recognized as revenue in the period received and as assets or decreases in liabilities, depending on the form of the benefits to be received.

The carrying amount of unconditional promises to give is reduced by a valuation allowance that reflects management's best estimate of amounts that will not be collected. Amounts that are expected to be collected after one year have been discounted at the time the pledge is recorded. The allowance for uncollectible amounts is based on management's assessment of the collectibility of specific promises to give. All accounts or portions thereof deemed to be uncollectible or to require an excessive collection cost are written off to the allowance for doubtful promises to give. The Agency believes unconditional promises to give are fully collectible at June 30, 2017 and 2016 and no allowance has been established.

Conditional promises to give are recognized only when the conditions on which they depend are substantially met and the promises become unconditional. There were no conditional promises to give as of June 30, 2017 and 2016.

Income Taxes

The Agency is recognized by the Internal Revenue Service as a tax exempt organization under Section 501(c)(3) of the Internal Revenue Code and, except for taxes pertaining to unrelated business income, is exempt from federal and state income taxes.

The Agency follows current accounting guidance which addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the consolidated financial statements. Under this guidance, the Agency may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by taxing authorities, based on the technical merits of the position. Examples of tax positions include the tax-exempt status of the Agency and various positions related to the potential sources of unrelated business income. The tax benefits recognized in the consolidated financial statements from such a position are measured based on the largest benefit that has a greater than 50 percent likelihood of being realized upon ultimate settlement. The guidance on accounting for uncertainty in income taxes also addresses de-recognition, classification, interest and penalties on income taxes.

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended June 30, 2017 and 2016

NOTE 1 - Summary of Significant Accounting Policies (cont.)

Income Taxes (cont.)

With few exceptions, the Agency is no longer subject to U.S. federal, state or local income tax examinations by tax authorities for the years before 2013. The Agency is not currently under examination by any taxing jurisdiction. It is the Agency's policy to recognize interest and penalties related to unrecognized tax expense when paid.

LSSI Rockford Property, Inc. has a tax year ending December 31. During 2010, LSSI Rockford Property, Inc. completed a sale that was treated for income tax purposes as an installment sale. The deferred tax liability of \$520,475 was included in other long-term liabilities as of June 30, 2017 and 2016 in the consolidated statements of financial position.

Investments

Investments are generally recorded at fair value based upon quoted market prices, when available, or estimates of fair value with gains and losses included in the consolidated statements of activities. Donated securities are recorded at fair value on the date received or at nominal value when the fair value is not readily available.

The Agency's external investment advisors are engaged to monitor and report on portfolio performance and to make recommendations to the Foundation's investment committee as to investment manager selection and or replacement, and asset allocations. Once those recommendations are approved, Agency management executes the necessary transactions to cause the investment portfolio to conform to the use of investment managers and the asset allocation percentages as approved. Monitoring and rebalancing of the investment portfolio is conducted on an on-going basis by management subject to the tolerances within the approved investment policy.

Property and Equipment

Property and equipment are stated at cost, if purchased, or fair value at the date of the gift, if donated. All acquisitions of property and equipment generally in excess of \$1,000 and all expenditures for repairs, maintenance, improvements and betterments that materially prolong the useful lives of assets are capitalized. Maintenance, repairs, and minor improvements are expensed as incurred. When assets are retired or otherwise disposed of, their costs and related accumulated depreciation are removed from the accounts and resulting gains or losses are included in the change in net assets.

Property and equipment are depreciated using the straight-line method over their estimated useful lives as follows:

Buildings	25 - 40 years
Other improvements	5 - 25 years
Furniture and equipment	3 - 7 years

LUTHERAN SOCIAL SERVICES OF ILLINOIS AND SUBSIDIARY CORPORATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS As of and for the Years Ended June 30, 2017 and 2016

NOTE 1 - Summary of Significant Accounting Policies (cont.)

Impairment of Long-Lived Assets

The Agency reviews long-lived assets for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or the fair value less costs to sell. To date, there have been no such losses recorded due to impairment.

Property Held for Sale

At June 30, 2016, the Agency held property with plans to sell it subsequent to year end. During 2017, the Agency sold the property for a gain of \$521,059 and included in gain on disposal of property and equipment on the consolidated statements of activities. The Agency held another property for sale at June 30, 2017 that was sold in September 2017. The sale price of the property was \$3,000,000, which will result in an approximate \$2,200,000 gain recognized in fiscal 2018. As part of the sale, the Agency will lease the building from the buyer through September 2024. The property was held as collateral on the note payable to the Mission Investment Fund (Note 9) and the note was paid in full at the time of the sale. The properties are reported in the consolidated statements of financial position as assets held for sale at their net book value of \$520,157 and \$252,580 at June 30, 2017 and 2016, respectively.

Escrow Deposit Accounts

At June 30, 2017 and 2016, the Agency had restricted cash totaling \$7,907,339 and \$6,842,318, respectively, mainly related to replacement reserves, tenant security deposits, residual receipts and minimum capital investments required by the U.S. Department of Housing and Urban Development ("HUD"). HUD regulations require these funds be held in segregated accounts. During 2015, HUD provided guidance to the Agency and other housing units on the repayment terms of residual receipts reserve balances. All amounts greater than \$250 per unit, totaling \$695,470 and \$1,752,555 at June 30, 2017 and 2016, respectively, are reflected as a liability.

The Agency had accounts held in escrow as a result of the sale of the nursing homes. The amounts held in escrow were \$0 and \$333,689 at June 30, 2017 and 2016, respectively.

Advertising

Non-direct advertising and promotion costs are charged to operations when incurred and for the years ended June 30, 2017 and 2016 the amounts included in continuing operations were \$116,818 and \$148,667, respectively.

Capital Advance and Assisted Living Conversion Grant Agreements

The deferred grant revenue from the capital advance and assisted living conversion agreements with HUD are being amortized over the terms of the agreements using the straight-line method.

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended June 30, 2017 and 2016

NOTE 1 - Summary of Significant Accounting Policies (cont.)

Split Interest Gift Arrangements

The Agency has entered into split interest gift arrangements that are mainly comprised of gift annuities and charitable trusts. Gift annuities provide that the annuitants will receive payments for life. The payments will continue even if related assets have been exhausted. At the death of the annuitants, all remaining assets, if any, are directed in accordance with the related agreements.

Charitable trusts provide that the income beneficiaries will receive payments for life, so long as there are assets available in the trust. At the death of the income beneficiaries, all remaining assets are directed in accordance with the related agreements.

At June 30, 2017 and 2016, the Agency held investments of \$1,840,882 and \$1,785,706, respectively, associated with these split interest agreements, which are recorded as investments held for long-term purposes on the consolidated statements of financial position.

The liability for split interest gift arrangements represents the present value of these obligations due to the annuitants and income beneficiaries. The present value was calculated based upon life expectancies using discount factors determined at the date of the gift that range from 1.2% to 10.6%.

Net Assets

Net assets, revenues, gains and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of the Agency are classified and reported as follows:

Unrestricted Net Assets - Net assets that are not subject to donor-imposed stipulations.

Temporarily Restricted Net Assets - Net assets subject to donor-imposed stipulations that either expire by passage of time or can be fulfilled and removed by actions of the Agency pursuant to those stipulations.

Permanently Restricted Net Assets - Net assets subject to donor-imposed stipulations that they be maintained permanently by the Agency.

Distributions

The Agency's regulatory agreements with HUD stipulate among other things, that the Agency will not make distributions of assets or income to any of its officers or directors.

Support and Revenues

Revenue is presented on the consolidated statements of activities net of billing adjustments.

The Agency receives a significant portion of its operating funds from grants and awards. These funds are reported as unrestricted support as the grants reimburse the Agency for services provided.

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended June 30, 2017 and 2016

NOTE 1 - Summary of Significant Accounting Policies (cont.)

Support and Revenues (cont.)

The Agency records contributions in accordance with current authoritative accounting guidance relating to accounting for contributions received and contributions made. The Agency receives contributions through pledges, bequests, in-kind gifts, life insurance premium payments, split interest gift arrangements and outright cash gifts. Contributions are classified as unrestricted, temporarily restricted or permanently restricted based on donor restrictions. Split interest gift arrangement receipts are classified partially as contributions and partially as a liability for the present value of the obligation. Upon the death of the annuitants or income beneficiaries, the remaining amount is classified as unrestricted or temporarily restricted based on donor directions.

Contributions that are restricted by the donor are reported as contributions in temporarily restricted or permanently restricted net assets, as appropriate. When a restriction expires, the temporarily restricted net assets are reclassified to unrestricted net assets. Investment income and realized and unrealized gains (losses) resulting from contributions are reported as unrestricted or temporarily restricted net assets, as designated by the donor. Investment income and realized and unrealized gains (losses) restricted by a donor are reported as increases (decreases) in temporarily restricted net assets and released when the restrictions are met.

Donated Services, Materials and Property

The Agency uses the services of volunteers who contribute their time and materials to provide services to the various programs. Volunteer hours utilized in 2017 and 2016 are not reflected in the consolidated financial statements as they generally do not require specialized skills.

Donations of property and equipment are recorded as support at their estimated fair value at the date of donation. Such donations are reported as unrestricted support unless the donor has restricted the donated asset to a specific purpose. Assets donated with explicit restrictions regarding their use and contributions of cash that must be used to acquire property and equipment are reported as restricted support. Absent donor stipulations regarding how long those donated assets must be maintained, the Agency reports expirations of donor restrictions when the donated or acquired assets are placed in service as instructed by the donor.

Functional Allocation of Costs

Certain costs have been allocated among the programs and supporting services benefited.

Operations

Operating results in the consolidated statements of activities reflect all transactions increasing or decreasing net assets except those items of a long-term nature, that is, those associated with:

Actuarial gains or losses on annuity obligations
Increase or decrease in actuarial pension costs

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended June 30, 2017 and 2016

NOTE 1 - Summary of Significant Accounting Policies (cont.)

Estimates

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

New Accounting Pronouncements

The Agency adopted Accounting Standards Update ("ASU") 2015-03, "Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs" during 2017. Under the new guidance, debt issuance costs related to a recognized debt liability are presented as a direct reduction to the carrying amount of that debt liability. ASU 2015-03 is to be applied retrospectively, and as a result, the guidance was retrospectively applied to 2016. The adoption of the standard decreased total assets and liabilities on the consolidated statements of financial position by \$460,491 at June 30, 2016. The amortization expense is included in interest expense on the consolidated statements of functional expenses and directly related program services revenue in 2017 and 2016.

During May 2014, Financial Accounting Standards Board ("FASB") issued ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)." ASU No. 2014-09 establishes principles for recognizing revenue upon the transfer of promised goods or services to customers, in an amount that reflects the expected consideration received in exchange for those goods or services. During 2015 and 2016, the FASB also issued various amendments which defer the effective date of ASU No. 2014-09, clarify the implementation guidance on principal versus agent considerations in Topic 606, and clarify the identification of performance obligations and the licensing implementation guidance. Topic 606 (as amended) is effective for fiscal years beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019. The Agency may elect to apply the guidance earlier, but no earlier than 2018. The amendments may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of initial application. The Agency is currently assessing the effect that Topic 606 (as amended) will have on its results of operations, financial position and cash flows.

FASB has issued ASU 2016-14, "Not-for-Profit Entities (Subtopic 958): Presentation of Financial Statements of Not-for-Profit Entities". ASU 2016-14 is intended to simplify and improve current net asset classification requirements and the information presented in financial statements and notes about a not-for-profit entity's liquidity, financial performance, expense classifications and cash flows. ASU 2016-14 is effective for fiscal years beginning after December 15, 2017, with early adoption permitted. Management is currently evaluating the impact of ASU 2016-14 on the Agency's consolidated financial statements.

In February 2016, FASB issued Accounting Standards Update No. 2016-02, "Leases (Topic 842)" that amends the treatment for leases. The new accounting model for leases capitalizes all leases greater than twelve months, both capital and operating, as assets and liabilities on the statement of financial position. The Agency will be required to apply the standard for fiscal years and reporting periods beginning after December 15, 2019. Early adoption is permitted. Management is currently evaluating the impact of ASU No. 2016-02 on the Agency's consolidated financial statements.

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended June 30, 2017 and 2016

NOTE 1 - Summary of Significant Accounting Policies (cont.)

New Accounting Pronouncements (cont.)

In November 2016, FASB issued ASU No. 2016-18, "Statement of Cash Flows (Topic 230): Restricted Cash" ("ASU No. 2016-18"). This standard will require cash flow statements to explain the change during a reporting period of the totals for cash, cash equivalents, restricted cash, and restricted cash equivalents. Amounts reported as restricted cash should be included with cash and cash equivalents when reconciling the beginning of period and end of period total amounts shown on the statement of cash flows. The update also includes a requirement that the footnotes to the financial statements explain the nature of the restrictions. The Agency will be required to apply the standard for fiscal years beginning after December 15, 2018. Early adoption will be permitted and the standard should be applied retrospectively upon adoption.

Reclassification

For comparability, certain 2016 amounts have been reclassified to conform with classifications adopted in 2017. The reclassifications have no effect on reported amounts of net assets or change in net assets.

NOTE 2 - Discontinued Operations

The Agency sold the Agency's two nursing homes, P.A. Peterson Center for Health and St. Matthew Center for Health, to a for profit corporation in fiscal year 2015. At June 30, 2017 and 2016, no assets and liabilities of the nursing homes remain on the consolidated statements of financial position and no income and expense related to the discontinued operations occurred during 2017 and 2016. Following is certain cash flow information for the discontinued operations:

	2017	2016
	Nursing Care Services	Nursing Care Services
Cash Flows From Operating Activities		
Changes in assets and liabilities:		
Accounts receivable, net	\$ -	\$ 68,842
Accounts payable and other accrued expenses	-	(586,382)
Net Cash Flows From Operating Activities	-	(517,540)
Cash Flows From Investing Activities		
Proceeds from sale of investments	-	10
Cash Flows From Financing Activities		
Net payments to LSSI	-	516,330
Net Change in Cash and Cash Equivalents from Discontinued Operations	\$ -	\$ (1,200)

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended June 30, 2017 and 2016

NOTE 3 - Management's Plan

The Agency experienced negative changes in net assets in fiscal years ended June 30, 2016 and 2015. Beginning in February 2016, management began the implementation of a plan to improve operating results and cash flows. The plan included program reductions, eliminations and transfers to other providers. The plan also included asset sales and refinancing transactions.

In 2016 and 2017, the Agency terminated programs that were operating at deficits. Additionally, the Agency incurred start-up costs in 2016 and 2017 to grow behavioral health services and generate additional revenues.

For the fiscal year ended June 30, 2017, the Agency experienced a positive change in net assets as well as positive net cash flows from operating activities, and disposals of property and equipment. As a result, line-of-credit use was reduced during the year.

The 2018 budget anticipates the Agency generating approximately \$1,000,000 of positive change in net assets. Management believes the Agency is appropriately sized to achieve these results in 2018 and in future years.

Management is continuously evaluating other changes in operations to improve financial performance and will adjust its plan accordingly.

NOTE 4 - Unconditional Promises To Give

Unconditional promises to give at June 30 consist of the following:

	<u>2017</u>	<u>2016</u>
Receivable in less than one year	\$ 167,323	\$ 817,320
Receivable in one to five years	<u>224,352</u>	<u>325,000</u>
Total unconditional promises to give	391,675	1,142,320
Less unamortized discount	<u>(38,005)</u>	<u>(38,005)</u>
Net unconditional promises to give	<u>\$ 353,670</u>	<u>\$ 1,104,315</u>

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended June 30, 2017 and 2016

NOTE 5 - Fair Value Measurements

The Agency follows authoritative accounting guidance relating to fair value measurements, which provides a framework for measuring, reporting and disclosing fair value under generally accepted accounting principles. This guidance applies to all assets and liabilities that are measured, reported and/or disclosed on a fair value basis.

As defined in current authoritative guidance, fair value is 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. In determining fair value, the Agency uses various valuation methods including the market, income and cost approaches. The assumptions used in the application of these valuation methods are developed from the perspective of market participants pricing the asset or liability. Inputs used in the valuation methods can be either readily observable, market corroborated, or generally unobservable inputs. Whenever possible the Agency attempts to utilize valuation methods that maximize the use of observable inputs and minimize the use of unobservable inputs. Based on the observability of the inputs used in the valuation methods the Agency is required to provide the following information according to the fair value hierarchy. The fair value hierarchy ranks the quality and reliability of the information used to determine fair values. Assets and liabilities measured, reported and/or disclosed at fair value will be classified and disclosed in one of the following three categories:

Level 1 - Quoted market prices in active markets for identical assets or liabilities.

Level 2 - Observable market based inputs or unobservable inputs that are corroborated by market data.

Level 3 - Unobservable inputs that are not corroborated by market data.

The table below presents the balances of assets measured at fair value on a recurring basis by level within the hierarchy.

	June 30, 2017			
	Level 1	Level 2	Level 3	Total
Cash and money market trust funds	\$ -	\$ 961	\$ -	\$ 961
Mutual funds	5,575,978	-	-	5,575,978
Beneficial interest in funds held in trust	-	-	808,087	808,087
Investments - restricted for collateral	-	11,024,527	-	11,024,527
Investments - trust accounts for split interest gift arrangements	1,015,734	825,148	-	1,840,882
Total	\$ 6,591,712	\$ 11,850,636	\$ 808,087	\$ 19,250,435

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended June 30, 2017 and 2016

NOTE 5 - Fair Value Measurements (cont.)

	June 30, 2016			
	Level 1	Level 2	Level 3	Total
Cash and money market trust funds	\$ -	\$ 961	\$ -	\$ 961
Mutual funds	2,635,996	-	-	2,635,996
Beneficial interest in funds held in trust	-	-	850,284	850,284
Investments - restricted for collateral	-	11,008,004	-	11,008,004
Investments - trust accounts for split interest gift arrangements	629,853	1,155,853	-	1,785,706
Total	\$ 3,265,849	\$ 12,164,818	\$ 850,284	\$ 16,280,951

Mutual funds and some investments - trust accounts for split interest gift arrangements - are measured at fair value using quoted market prices. They are classified as Level 1 as they are traded in an active market.

Cash and money market trust funds, some investments - restricted for collateral, and some investments - trust accounts for split interest gift arrangements - are measured at fair value using multiple sources of information that are corroborated by market data and are considered Level 2 items.

Beneficial interest in funds held in trust - Trusts that the Agency is named as the beneficiary in which they are not the trustee of the assets are considered Level 3 items as the valuation is based on significant unobservable inputs that are not corroborated by market data.

A determination to classify a financial instrument within Level 3 of the valuation hierarchy is based upon the significance of the unobservable factors to the overall fair value measurement. However, Level 3 financial instruments typically include, in addition to the unobservable or Level 3 components, observable components; accordingly, the gains and losses in the table below include changes in fair value due in part to observable factors that are included within the valuation methodology.

The changes in level 3 assets measured at fair value on a recurring basis are summarized below for the year ended June 30, 2017:

	<u>Beneficial interest in funds held in trust</u>
Balance at June 30, 2016	\$ 850,284
Net realized and unrealized gains included in the change in net assets	52,571
Distributions to LSSI	(94,768)
Balance at June 30, 2017	\$ 808,087

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended June 30, 2017 and 2016

NOTE 5 - Fair Value Measurements (cont.)

The changes in level 3 assets measured at fair value on a recurring basis are summarized below for the year ended June 30, 2016:

	<u>Beneficial interest in funds held in trust</u>
Balance at June 30, 2015	\$ 893,129
Net realized and unrealized losses included in the change in net assets	<u>(42,845)</u>
Balance at June 30, 2016	<u>\$ 850,284</u>

The Agency's financial instruments, excluding investments, consist principally of cash, accounts receivable, unconditional promises to give, other assets, cash surrender value of life insurance, accounts payable, line of credit, a note payable and other liabilities, all whose carrying value approximates fair value as they are short term in nature. Due to the special terms of the agreements, it is not practical to estimate the fair value of the HUD related long-term debt including mortgages payable, capital advances and assisted living conversion agreements.

NOTE 6 - Short-Term Investments and Investments Pledged as Collateral

Investments and related unrealized appreciation (depreciation) as of June 30, 2017 are summarized as follows:

	<u>Cost or Gift Value</u>	<u>Unrealized Appreciation (Depreciation)</u>	<u>Total Investments at Fair Value</u>
LSSI Funds:			
Mainstay Marketfield Fund	\$ 66,000	\$ 234,903	\$ 300,903
Foundation Funds:			
Schwab Money Market Fund	961	-	961
MaxSafe Money Market Fund - restricted for collateral	11,024,527	-	11,024,527
Dodge and Cox Fund	842,065	166,265	1,008,330
DFA Emerging Market Fund	202,841	54,465	257,306
Vanguard Short Term Bond	1,788,221	(25,973)	1,762,248
Vanguard Total Stock Market Fund	<u>1,880,373</u>	<u>366,767</u>	<u>2,247,140</u>
Subtotal Foundation funds	<u>15,738,988</u>	<u>561,524</u>	<u>16,300,512</u>
Total short-term investments and short-term investments held as collateral	<u>\$ 15,804,988</u>	<u>\$ 796,427</u>	<u>\$ 16,601,415</u>

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended June 30, 2017 and 2016

NOTE 6 - Short-Term Investments and Investments Pledged as Collateral (cont.)

Investments and related unrealized appreciation (depreciation) as of June 30, 2016 are summarized as follows:

	<u>Cost or Gift Value</u>	<u>Unrealized Appreciation (Depreciation)</u>	<u>Total Investments at Fair Value</u>
LSSI Funds:			
Mainstay Marketfield Fund	\$ 66,000	\$ 82,486	\$ 148,486
Foundation Funds:			
Schwab Money Market Fund	961	-	961
MaxSafe Money Market Fund - restricted for collateral	11,008,004	-	11,008,004
Dodge and Cox Fund	810,963	(37,551)	773,412
DFA Emerging Market Fund	200,094	1,575	201,669
Vanguard Short Term Bond	96,096	683	96,779
Vanguard Total Stock Market Fund	<u>1,287,868</u>	<u>77,724</u>	<u>1,365,592</u>
Subtotal Foundation funds	<u>13,403,986</u>	<u>42,431</u>	<u>13,446,417</u>
Total short-term investments and short-term investments held as collateral	<u>\$ 13,469,986</u>	<u>\$ 124,917</u>	<u>\$ 13,594,903</u>

For the investments held within the Foundation, interest and dividend income and net realized and unrealized gains (losses) are allocated monthly to unrestricted and temporarily restricted net assets based on the relationship of the net assets of each fund to the total net assets, as adjusted for additions to or deductions from those funds. All other investment earnings are recorded as increases (decreases) in unrestricted net assets.

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended June 30, 2017 and 2016

NOTE 7 - Investments - Held for Long-Term Purposes

Investments related to life annuity contracts and for the Andrew E. Seaver Trust Fund are stated at fair value. Investments and unrealized appreciation (depreciation) at June 30, 2017 are summarized as follows:

	Cost	Unrealized Appreciation (Depreciation)	Fair Value
Foundation investments related to life annuity contracts			
Money Market fund	\$ 45,324	\$ -	\$ 45,324
Charitable Bond mutual fund	635,555	1,844	637,399
Charitable Equity mutual fund	830,593	110,137	940,730
Tangible Assets mutual fund	50,402	(15,982)	34,420
Other funds	178,687	4,322	183,009
Subtotal	1,740,561	100,321	1,840,882
ELCA Endowment Fund	621,728	186,359	808,087
Unrestricted investments			
Other investments	51	-	51
Total Investments Held for Long-Term Purposes	\$ 2,362,340	\$ 286,680	\$ 2,649,020

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended June 30, 2017 and 2016

NOTE 7 - Investments - Held for Long-Term Purposes (cont.)

Investments and unrealized appreciation at June 30, 2016 are summarized as follows:

	<u>Cost</u>	<u>Unrealized Appreciation (Depreciation)</u>	<u>Fair Value</u>
Foundation Investments related to life annuity contracts			
Money Market fund	\$ 50,582	\$ (3,576)	\$ 47,006
Charitable Bond mutual fund	712,599	(72,505)	640,094
Charitable Equity mutual fund	1,030,247	(186,430)	843,817
Tangible Assets mutual fund	41,814	(5,250)	36,564
Real Estate mutual fund	81,188	(3,868)	77,320
Other funds	<u>184,059</u>	<u>(43,154)</u>	<u>140,905</u>
Subtotal	<u>2,100,489</u>	<u>(314,783)</u>	<u>1,785,706</u>
 ELCA Endowment Fund	 <u>564,917</u>	 <u>186,359</u>	 <u>751,276</u>
 Andrew E. Seaver Trust Fund			
Common Stock	30,071	3,421	33,492
Corporate Bonds	67,476	(7,105)	60,371
Real Estate	1,924	132	2,056
Commodities	2,916	(913)	2,003
Cash	<u>1,128</u>	<u>(93)</u>	<u>1,035</u>
Subtotal	<u>103,515</u>	<u>(4,558)</u>	<u>98,957</u>
 Unrestricted investments			
Mission Investment Fund - ELCA	50,058	-	50,058
Other investments	<u>51</u>	<u>-</u>	<u>51</u>
Subtotal	<u>50,109</u>	<u>-</u>	<u>50,109</u>
Total Investments Held for Long-Term Purposes	<u>\$ 2,819,030</u>	<u>\$ (132,982)</u>	<u>\$ 2,686,048</u>

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended June 30, 2017 and 2016

NOTE 7 - Investments - Held for Long-Term Purposes (cont.)

The following schedules summarize the investment return, which includes interest on cash and cash equivalents, short-term and long-term investments, and its classification in the consolidated statements of activities:

	2017		
	Unrestricted	Temporarily Restricted	Total
Interest and dividend income	\$ 413,470	\$ 29,380	\$ 442,850
Net realized and unrealized gains	487,684	121,472	609,156
Total investment return	\$ 901,154	\$ 150,852	\$ 1,052,006
	2016		
	Unrestricted	Temporarily Restricted	Total
Interest and dividend income	\$ 332,327	\$ 21,700	\$ 354,027
Net realized and unrealized losses	(955,834)	(277,057)	(1,232,891)
Total investment return	\$ (623,507)	\$ (255,357)	\$ (878,864)

NOTE 8 - Line of Credit

The Agency has a revolving line of credit agreement with Wintrust Bank for borrowings up to \$11,000,000 which expires on December 18, 2018. The line of credit is secured by a Foundation guaranty in a pledged asset account at Wintrust in a MaxSafe TM account. As of June 30, 2017 and 2016, the fair value of the assets in the pledged account was \$11,024,527 and \$11,008,004, respectively. As of June 30, 2017 and 2016, the Agency's borrowing under the line was \$2,209,000 and \$8,147,000, respectively.

Interest expense on the line of credit was \$110,119 and \$135,570 in 2017 and 2016, respectively.

The Agency and the Foundation are subject to certain covenants. The Agency and the Foundation were in compliance as of June 30, 2017.

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended June 30, 2017 and 2016

NOTE 9 - Long-Term Debt

Long-term debt at June 30 consists of the following:

	2017	2016
Mortgages Payable:		
Wells Fargo with monthly payments of \$51,135, including interest at 9.0%, due July 1, 2019. After applying an FHA interest subsidy to monthly installment payments, interest is reduced to an approximate effective rate of 1%. The mortgage is secured by land and building and is insured by HUD under section 223(f) of the National Housing Act. The mortgage was refinanced in 2017. (Salem Village III, Inc.)	\$ -	\$ 1,646,807
P/R Mortgage & Investment Corp. with monthly payments of \$64,828 including interest at 3.38%, until September 1, 2019. Starting October 1, 2019 payments are reduced to monthly payment of \$30,697 including interest at 3.38%. Any remaining principal or interest is due July 1, 2052. The property is secured by a mortgage on the Project's building and land and insured by HUD under Section 223(f) of the National Housing Act. The Project also has a FHA interest subsidy which offsets interest expense until the subsidy expires June 1, 2019. (Salem Village III, Inc.)	8,376,800	-
Mission Investment Fund ("MIF") with monthly payments of \$11,825, including interest at 3.75% adjusted every 3 years to MIF's current rate, due March 31, 2041 secured by land and building.	2,227,601	2,289,563
Mortgage Payable with P/R Mortgage & Investment Corp. in the amount of \$5,368,000. Monthly payments of \$23,607, including interest at 3.95% were required beginning September 1, 2013, balance due August 1, 2048. The mortgage payable is secured by a mortgage on the rental property and insured by HUD under Section 223(f) of the National Housing Act. (Batavia Council on Aging, Inc.)	5,073,645	5,154,757
HUD, due July 1, 2019, with interest at the rate of 1% per annum which will not be compounded, payable at maturity, secured by restricted deposits, land and building. The mortgage was refinanced in 2017. (Salem Village III, Inc.)	-	1,028,977
HUD with monthly payments of \$5,056, including interest at 7.63%, due July 1, 2021, secured by land and building and cannot be prepaid. (DeKalb Housing for the Handicapped, Inc.)	212,286	254,982

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended June 30, 2017 and 2016**

NOTE 9 - Long-Term Debt (cont.)

	2017	2016
Mortgages Payable:		
HUD insured mortgage payable to Centennial Mortgage, Inc. with monthly payments of \$38,491 including interest at 4.45%, due May 1, 2045, secured by the Project's land and buildings and is insured by HUD under Section 223(f) of the National Housing Act. This mortgage was paid in full in 2017. (Luther Center, Inc.)	\$ -	\$ 7,506,383
Total Mortgages Payable	15,890,332	17,881,469
Less: Current Maturities	(704,481)	(831,423)
Long-Term Portion of Mortgages Payable	\$ 15,185,851	\$ 17,050,046
Less: loan costs, net of accumulated amortization	(445,160)	(460,491)
Total Long-Term Portion of Mortgages Payable, Net	\$ 14,740,691	\$ 16,589,555

Legal and accounting fees, printing costs, and other expenses associated with the issuance of debt held by the Agency are included in mortgages payable and are amortized over the term of the mortgages on a straight line basis. Amortization included in interest expense charged to the consolidated statements of activities for the years ended June 30, 2017 and 2016 was \$13,749 and \$15,247, respectively. At June 30, 2017 and 2016, the remaining net amount of debt issuance costs was \$445,160 and \$460,491, respectively.

The Agency leased certain equipment under eight capital leases during 2017 and 2016. At June 30, 2017 and 2016, the gross value of these assets was \$510,454 and \$544,461, respectively, and the related accumulated amortization was \$372,309 and \$278,758, respectively. The assets are included in property and equipment in the consolidated statements of financial position.

The MIF note payable was paid in full in September 2017 when the collateral of land and building was sold. The following annual principal maturities of the above mortgages, notes and capital leases for the next five years, excluding the MIF note payable, are as follows:

2018	\$ 667,579
2019	681,113
2020	353,404
2021	288,841
2022	234,861
Thereafter	11,566,611
Total	\$ 13,792,409

Total interest expense including amortization of debt issuance costs and other bank fees was \$794,913 and \$823,501 in 2017 and 2016, respectively. The amount of interest to be paid during future years on capital leases is \$10,800.

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended June 30, 2017 and 2016

NOTE 10 - Capital Advance Agreements

The Agency has funded the construction of various housing projects through capital advance agreements with HUD, which provided for borrowings not to exceed \$64,779,300 at June 30, 2017 and 2016. The agreements are given to the HUD Projects in the form of mortgage notes and bear no interest and require no repayment provided that the housing to which it relates remains available for low-income elderly or developmentally disabled persons in accordance with the appropriate regulations. The amount drawn at June 30, 2017 and 2016 was \$64,779,300. Grant revenue from the capital advance agreements is being recognized over the terms of the agreements on a straight-line basis. During the years ended June 30, 2017 and 2016, the Agency recognized revenue of \$1,640,448 on these agreements.

The deferred grant revenue recorded at June 30 consists of capital advance agreements for the following HUD Projects:

	2017			
	Year of Expiration	Amount Drawn to Date	Grant Revenue Recognized to Date	Deferred Grant Revenue
Assisi Homes-Downer Place, Inc.	2039	\$ 7,057,900	\$ 3,042,201	\$ 4,015,699
Our Savior's Senior Housing, Inc.	2035	6,059,600	3,320,112	2,739,488
Tabor Lutheran Senior Housing, Inc.	2038	5,884,600	2,592,400	3,292,200
Rochelle Senior Housing, Inc.	2036	3,531,400	1,828,256	1,703,144
Freeport Senior Housing, Inc.	2033	3,197,300	1,894,194	1,303,106
Northwest Chicago Group Homes, Inc.	2034	1,483,800	863,409	620,391
Freeport Senior Housing II, Inc.	2042	3,039,200	1,108,554	1,930,646
Aurora Senior Housing, Inc.	2040	3,895,500	1,554,774	2,340,726
Victorian Woods Senior Living, Inc.	2046	6,524,200	1,788,019	4,736,181
Spring Ridge Housing for Seniors, Inc.	2048	7,759,800	1,789,480	5,970,320
Rolling Meadows Senior Living, Inc.	2049	3,290,600	651,225	2,639,375
Deer Creek Manor, Inc.	2049	3,568,300	683,928	2,884,372
Fox Hill Senior Housing, Inc.	2053	9,487,100	909,190	8,577,910
Total		\$ 64,779,300	\$ 22,025,742	\$ 42,753,558

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended June 30, 2017 and 2016

NOTE 10 - Capital Advance Agreements (cont.)

	2016			
	Year of Expiration	Amount Drawn to Date	Grant Revenue Recognized to Date	Deferred Grant Revenue
Assisi Homes-Downer Place, Inc.	2039	\$ 7,057,900	\$ 2,859,669	\$ 4,198,231
Our Savior's Senior Housing, Inc.	2035	6,059,600	3,168,624	2,890,976
Tabor Lutheran Senior Housing, Inc.	2038	5,884,600	2,436,856	3,447,744
Rochelle Senior Housing, Inc.	2036	3,531,400	1,739,792	1,791,608
Freeport Senior Housing, Inc.	2033	3,197,300	1,813,590	1,383,710
Northwest Chicago Group Homes, Inc.	2034	1,483,800	826,005	657,795
Freeport Senior Housing II, Inc.	2042	3,039,200	1,032,102	2,007,098
Aurora Senior Housing, Inc.	2040	3,895,500	1,454,466	2,441,034
Victorian Woods Senior Living, Inc.	2046	6,524,200	1,624,231	4,899,969
Spring Ridge Housing for Seniors, Inc.	2048	7,759,800	1,594,264	6,165,536
Rolling Meadows Senior Living, Inc.	2049	3,290,600	568,293	2,722,307
Deer Creek Manor, Inc.	2049	3,568,300	595,392	2,972,908
Fox Hill Senior Housing, Inc.	5053	9,487,100	672,010	8,815,090
Total		<u>\$ 64,779,300</u>	<u>\$ 20,385,294</u>	<u>\$ 44,394,006</u>

NOTE 11 - Federal Home Loan Grant Agreements

The Agency received grants totaling \$190,000 from One Mortgage Partners Corporation, a member of the Federal Home Loan Bank of Chicago, to partially fund the construction of two housing projects. The grants are in the form of mortgage notes which bear no interest and require no repayment provided that the housing to which they relate remains available for low-income elderly persons in accordance with the appropriate regulations and other grant requirements. Grant revenue from the agreements is being recognized over the terms of the agreements on a straight-line basis. During the years ended June 30, 2017 and 2016, the Agency recognized revenue of \$12,672 on these agreements. The deferred revenue recorded at June 30, 2017 and 2016 is \$91,348 and \$104,020, respectively.

NOTE 12 - Assisted Living Conversion Grant Agreement

The Agency has funded the conversion of 56 units at Salem Village III, Inc. ("Salem Village") housing project to assisted living units through an Assisted Living Conversion Grant Agreement with HUD, which provided for borrowings not to exceed \$6,339,159. This agreement provides funding for physical costs of the conversion, legal, architectural and consulting fees, and temporary relocation costs, including vacancy losses. The agreement requires no principal and interest payments as long as Salem Village is used for approved purposes until July 1, 2039. The agreement is secured by the related building. If the Project does not comply with the terms of the agreement, the entire assisted living conversion grant amount would be required to be paid back to HUD.

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended June 30, 2017 and 2016

NOTE 12 - Assisted Living Conversion Grant Agreement (cont.)

Funding of \$514,240 was recognized in prior years relating to vacancy losses. Remaining grant revenue of \$5,824,919 from this agreement is being recognized over the term of the agreement on a straight-line basis, beginning with the in-service dates of all of the converted units. Revenue realized from the conversion costs for the years ended June 30, 2017 and 2016 was \$180,156. The deferred revenue recorded at June 30, 2017 and 2016 was \$3,963,307 and \$4,143,463, respectively.

NOTE 13 - Pension Plan

Prior to January 1, 2010 the Agency was a participant in the retirement plan for employees of the United Way of Metropolitan Chicago and participating agencies, which covered substantially all employees hired prior to July 1, 2006. As of January 1, 2010, the Pension Equity Plan for employees of Lutheran Social Services of Illinois was separated from the United Way plan. This change had no effect on plan assets, liabilities, employee benefits or Agency funding requirements. The Agency uses a June 30 measurement date for the plan.

As of July 1, 2006, entry by new employees into the Agency's pension plan was frozen. All Agency employees who were hired prior to July 1, 2006 became eligible to participate in the pension plan in accordance with the terms of the plan, and all employees who were participants in the plan on July 1, 2006 shall continue as participants until their benefits are distributed in accordance with the terms of the plan.

During the year ended June 30, 2009, the Agency froze additional benefit accruals under the plan, resulting in a plan curtailment. Participants in the Agency's defined benefit plan became eligible for employer contributions under the Agency's defined contribution plan effective January 1, 2009.

Included in unrestricted net assets at June 30, 2017 and 2016 are the following amounts that have not yet been recognized in net periodic pension cost: unrecognized actuarial net losses of \$14,129,906 and \$19,672,071, respectively. The actuarial loss included in unrestricted net assets and expected to be recognized in net periodic pension costs during the fiscal year ending June 30, 2018 is \$1,258,627.

The table below presents details about the Agency plan including the changes in accumulated benefit obligations, the fair value of plan assets, and funded status for the years ended June 30 (actuarial values of the benefit obligation were calculated as of June 30, 2017 and 2016, respectively).

	2017	2016
Change in benefit obligation		
Accumulated benefit obligation at beginning of year	\$ 45,749,803	\$ 44,250,770
Provision for expenses	400,000	400,000
Interest cost	1,394,661	1,668,469
Actuarial (gain) loss	(2,770,527)	3,511,724
Settlements**	(2,085,914)	(2,244,509)
Benefits paid	(2,866,579)	(1,836,651)
Accumulated benefit obligation at end of year	\$ 39,821,444	\$ 45,749,803

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended June 30, 2017 and 2016

NOTE 13 - Pension Plan (cont.)

Since benefit accruals have been frozen, the projected benefit obligation is equal to the accumulated benefit obligation at June 30, 2017 and 2016.

	2017	2016
Change in plan assets		
Fair value of plan assets at beginning of year	\$ 28,850,084	\$ 32,795,045
Actual return on assets	2,144,031	(581,591)
Employer contribution	150,000	717,790
Settlements**	(2,085,914)	(2,244,509)
Benefits paid	(2,866,579)	(1,836,651)
Fair value of plan assets at end of year	\$ 26,191,622	\$ 28,850,084
Funded status of the plan	\$ (13,629,822)	\$ (16,899,719)
Components of benefit cost		
Provision for expense	\$ 400,000	\$ 400,000
Interest cost	1,394,661	1,668,469
Expected return on plan assets	(1,814,183)	(2,044,233)
Recognized actuarial loss	1,574,532	1,488,751
Net periodic benefit costs	1,555,010	1,512,987
Cost for settlements**	867,258	965,122
Total benefit cost	\$ 2,422,268	\$ 2,478,109

** Settlements occurred during 2017 and 2016 due to the amount of lump sum payments provided to plan participants exceeding the service and interest costs. The settlement costs were \$2,085,914 and \$2,244,509, respectively.

The underfunded status of the plan of \$13,629,822 and \$16,899,719 at June 30, 2017 and 2016, respectively, is recognized in the accompanying consolidated statements of financial position as long-term liability for pension benefits.

The following are weighted average assumptions used to determine benefit obligations at June 30:

	2017	2016
Discount rate	3.60%	3.30%

There were no participant contributions made to the plan during the years ended June 30, 2017 and 2016.

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended June 30, 2017 and 2016

NOTE 13 - Pension Plan (cont.)

The following are weighted-average assumptions used to determine net periodic benefit cost for the years ended June 30:

	2017	2016
Discount rate	3.30%	3.96%
Expected return on plan assets	6.50%	6.50%

The Agency's expected long-term return on plan assets assumption is based on a periodic review and modeling of the plan's asset allocation over a long-term horizon. Expectations of returns for each asset class are the most important of the assumptions used in the review and modeling and are based on comprehensive reviews of historical data and economic/financial market theory. The expected long-term rate of return on assets was selected from within the reasonable range of rates determined by historical real returns for the asset classes covered by the investment policy.

The Agency's plan assets at June 30, 2017, by asset category are as follows:

	Level 1	Level 2	Level 3	Total
Cash and money market funds	\$ -	\$ 350,000	\$ -	\$ 350,000
Mutual funds	17,609,817	8,231,805	-	25,841,622
Total	\$ 17,609,817	\$ 8,581,805	\$ -	\$ 26,191,622

The Agency's plan assets at June 30, 2016, by asset category are as follows:

	Level 1	Level 2	Level 3	Total
Cash and money market funds	\$ -	\$ 283,593	\$ -	\$ 283,593
Mutual funds	18,009,200	6,974,647	-	24,983,847
Hedge fund of funds	-	-	3,582,644	3,582,644
Total	\$ 18,009,200	\$ 7,258,240	\$ 3,582,644	\$ 28,850,084

Cash and money market funds - These investments are measured at fair value using multiple sources of information that are corroborated by market data and are considered Level 2 items.

Mutual funds - These investments consist of Vanguard Long-Term Investment Grade Fund, Vanguard Intermediate Term Corporate Fund, Dodge and Cox Stock Fund, American Funds Euro Pacific Growth Fund, Harbor International Fund Institutional Class, MainStay Marketfield Fund and Touchstone Sands Capital Institutional Growth Fund, and are measured at fair value using quoted market prices. They are classified as Level 1 as they are traded in an active market. In addition, the Agency is invested in the Comerica S&P Composite 1500 Index Fund, which is not actively traded and is considered a Level 2 item.

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended June 30, 2017 and 2016

NOTE 13 - Pension Plan (cont.)

Hedge funds - Investments in hedge funds have no readily determinable fair value and are classified as Level 3 as the valuation is based on significant unobservable inputs that are not corroborated by market data. The valuation was determined by the investment managers.

The hedge fund held at June 30, 2016 consisted of Grosvenor Capital Management LP which is a multi-strategy hedge fund-of-fund. The fund was diversified through various sectors of investments including equity long/short, event driven, multi-strategy, credit, macro, and tail risk managers. Allocations by sector range from 10% to 40% with no individual manager having an allocation greater than 4%. The return objective was between equity and fixed income returns with volatility at half of the equity market.

The changes in level 3 assets measured at fair value on a recurring basis are summarized below for the year ended June 30, 2017:

	Hedge funds
Balance at June 30, 2016	\$ 3,582,644
Net realized and unrealized gains	182,653
Sales	(3,765,297)
Balance at June 30, 2017	\$ -

The changes in level 3 assets measured at fair value on a recurring basis are summarized below for the year ended June 30, 2016:

	Hedge funds
Balance at June 30, 2015	\$ 3,450,044
Net realized and unrealized gains	132,600
Balance at June 30, 2016	\$ 3,582,644

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended June 30, 2017 and 2016

NOTE 13 - Pension Plan (cont.)

The Agency's investment policy includes various guidelines and procedures designed to ensure assets are invested in a manner necessary to meet expected future benefits earned by participants. The investment guidelines consider a broad range of economic conditions.

The objectives of the target allocations are to maintain investment portfolios that diversify risk through prudent asset allocation parameters, achieve asset returns that meet or exceed the plan's actuarial assumptions, and achieve asset returns that are competitive with like institutions employing similar investment strategies.

The investment policy is periodically reviewed by the Agency. The policy is established and administered in a manner so as to comply at all times with applicable government regulations.

The estimated net periodic benefit cost for 2018 is:

Provision for expense		\$ 500,000
Interest cost		1,383,397
Expected return on assets		(1,773,725)
Amortization of net loss		1,148,955
Estimated net periodic benefit cost		<u>\$ 1,258,627</u>

The following pension benefit payments are expected to be paid:

2018		\$ 2,787,490
2019		2,426,061
2020		2,379,805
2021		2,339,761
2022		4,703,143
2023-2027		13,829,857

The Agency is anticipating making \$1,395,000 in contributions to the plan during the year ending June 30, 2018.

The discount rate and expected rate of return on plan assets are critical assumptions which significantly affect pension accounting. Even relatively small changes in these rates would significantly change the recorded pension expense and accrued liability. The expected return on plan assets is computed based on an asset valuation method which recognizes gains/losses over a period of five years. Management believes the discount rate and expected rate of return on plan assets used in determining its year-end pension accounting are reasonable based on currently available information. However, it is at least reasonably possible that these assumed rates will be revised in the near term, based on future events and changes in circumstances.

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended June 30, 2017 and 2016

NOTE 14 - Defined Contribution Retirement Plan

The Agency has adopted a defined contribution retirement plan ("Plan") under Internal Revenue code section 403(b). All Agency employees (except temporary employees) who have completed one year of service are eligible to participate in the Plan. All such eligible employees, who are at least age 21, may elect to make contributions to the Plan through salary deductions. There is no minimum service requirement to make employee contributions to the Plan. Under the Plan, the Agency may make a discretionary annual employer contribution to eligible participants. There was no Agency contribution to the Plan for the years ending June 30, 2017 and 2016.

NOTE 15 - Worker's Compensation Trust

The Agency has a self-funded Worker's Compensation Trust (the "Trust") which is organized and operated under the provisions of the Illinois Religious and Charitable Risk Pooling Trust Act. The trustees of the Trust are appointed by the Agency.

The Agency makes monthly contributions to the Trust. The Agency has recorded a liability for unpaid contributions, which includes unpaid claims and claims incurred but not reported, of \$1,013,802 and \$1,286,493 at June 30, 2017 and 2016, respectively. The estimated liability is classified as accounts payable and other accrued expenses on the consolidated statements of financial position.

The Agency has established a cash reserve account for the worker's compensation trust with a balance of \$1,384,949 and \$1,380,000 at June 30, 2017 and 2016, respectively, which is included in cash and cash equivalents.

NOTE 16 - Accrued Salaries and Wages

Accrued salaries and wages include accrued vacation pay of \$1,819,017 and \$1,869,681 at June 30, 2017 and 2016, respectively.

NOTE 17 - Accrued Unemployment

The Agency pays for Illinois unemployment compensation on a claims-made basis. At June 30, 2017 and 2016, \$200,000 and \$703,046, respectively, was accrued as the estimated liability for these claims. These amounts are classified as accounts payable and other accrued expenses on the consolidated statements of financial position.

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended June 30, 2017 and 2016

NOTE 18 - Net Assets

Net assets have been received to be held in perpetuity for several programs. The amounts of these net assets as of June 30 are shown below by program and purpose:

	2017	2016
Adoption services	\$ 131,736	\$ 131,736
Behavioral health	16,248	16,248
Child and adolescent	203,223	203,223
Children and disabled individuals	302,802	302,802
Children and older adults	1,191,190	1,191,190
Endowment for general use	546,194	546,194
Leadership and awards	116,090	116,090
Older adults	267,875	267,875
Other programs	5,575	5,575
Services outside metropolitan Chicago	47,361	47,361
Total Permanently Restricted Net Assets	\$ 2,828,294	\$ 2,828,294

The income from these assets must be used in support of the aforementioned programs and purposes.

Temporarily restricted net assets are available for the following programs, purposes and periods as directed by the donors as of June 30:

	2017	2016
Adoption services	\$ 45,588	\$ 39,996
Administration	306,793	306,793
Behavioral health	156,956	193,711
Child and adolescent	360,082	300,700
Children and disabled individuals	587,636	559,551
Children and older adults	514,439	460,650
Disaster relief	1,058,088	1,105,193
Leadership and awards	107,216	100,636
Older adults	147,720	171,799
Other programs	650,338	626,468
Prisoner and family ministry	-	95,866
Total Temporarily Restricted Net Assets	\$ 3,934,856	\$ 3,961,363

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended June 30, 2017 and 2016

NOTE 18 - Net Assets (cont.)

Net assets were released from temporary donor restrictions by expending funds for the following purposes during the years ended June 30:

	2017	2016
Behavioral health	66,000	28,540
Child and adolescent	111,336	24,140
Prisoner and family ministry	95,934	69,000
Transfer for split interest gift arrangements and charitable trusts between unrestricted net assets and net assets temporarily restricted	24,108	(25,149)
Expiration of time restrictions	68,277	260,484
Total Net Assets Released from Restriction	\$ 365,655	\$ 357,015

NOTE 19 - Endowment Funds

The Agency follows current authoritative accounting guidance relating to endowments of not-for-profit organizations and enhanced disclosures for all endowment funds. Guidance is provided on classifying net assets associated with donor-restricted endowment funds held by organizations that are subject to an enacted version of Uniform Prudent Management of Institutional Funds Act ("UPMIFA"). A key component of the guidance and UPMIFA is a requirement to classify the portion of a donor-restricted endowment fund that is not classified as permanently restricted net assets as temporarily restricted net assets until appropriated for expenditure. Another key component of the guidance is a requirement for expanded disclosures about all endowment funds.

The Agency's endowment consists of approximately 40 individual funds established for a variety of purposes. Its endowment includes both donor-restricted endowment funds and funds designated by the Board of Trustees of the Foundation to function as endowment. Any permanently restricted contributions received from donors are included in the donor restricted endowment fund. Any other named fund or special purpose fund that donors have established are included in board-designated endowment and any restrictions are reflected in the endowment. As required by accounting principles generally accepted in the United States of America ("GAAP"), net assets associated with endowment funds, including funds designated by the Foundation's board of trustees to function as endowment, are classified and reported based on the existence or absence of donor-imposed restrictions.

The Foundation considers a portion of the funds due from LSSI to be a part of the endowment. The Foundation has advanced LSSI a significant portion of the "Board-designated" endowment funds without interest, during the years ended June 30, 2017 and 2016. The amount loaned to LSSI was \$1,943,827 and \$2,765,153 at June 30, 2017 and 2016, respectively, and the balance is eliminated on the consolidated financial statements. A significant portion of the Foundation's investments are pledged as collateral on the Agency's line of credit (Note 8).

Interpretation of Relevant Law -The Agency classifies as permanently restricted net assets (a) the original value of the gifts donated to the permanent endowment and (b) the original value of subsequent gifts to the permanent endowment.

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended June 30, 2017 and 2016

NOTE 19 - Endowment Funds (cont.)

The remaining portion of the donor-restricted endowment fund that is not classified as permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Agency in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the Agency considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

1. The duration and preservation of the fund
2. The purposes of the Agency and the donor-restricted endowment fund
3. General economic conditions
4. The possible effect of inflation and deflation
5. The expected total return from income and the appreciation of investments
6. Other resources of the Agency
7. The investment policies of the Agency

The following description of the endowment represents the activity at the Foundation. The Foundation guarantees the line of credit which has investment limitations. Management of LSSI intends to improve the financial position of the Agency to obtain net asset balances to meet the obligations of the endowment and invest the endowment assets according to its policy.

Endowment net asset composition by type of fund consists of the following as of June 30, 2017:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ -	\$ 943,298	\$ 2,828,294	\$ 3,771,592
Board-designated endowment funds	<u>13,721,271</u>	<u>2,100,114</u>	<u>-</u>	<u>15,821,385</u>
Total endowment funds	<u>\$ 13,721,271</u>	<u>\$ 3,043,412</u>	<u>\$ 2,828,294</u>	<u>\$ 19,592,977</u>

Endowment net asset composition by type of fund consists of the following as of June 30, 2016:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ -	\$ 851,233	\$ 2,828,294	\$ 3,679,527
Board-designated endowment funds	<u>13,659,361</u>	<u>2,124,327</u>	<u>-</u>	<u>15,783,688</u>
Total endowment funds	<u>\$ 13,659,361</u>	<u>\$ 2,975,560</u>	<u>\$ 2,828,294</u>	<u>\$ 19,463,215</u>

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended June 30, 2017 and 2016

NOTE 19 - Endowment Funds (cont.)

Changes in endowment net assets for the years ended June 30 are as follows:

	2017			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, June 30, 2016	\$ 13,659,361	\$ 2,975,560	\$ 2,828,294	\$ 19,463,215
Investment return				
Investment income	117,579	29,380	-	146,959
Net appreciation realized and unrealized	454,480	121,472	-	575,952
Total investment return	572,059	150,852	-	722,911
Contributions	273,092	-	-	273,092
Appropriation for expenditure	(783,241)	(83,000)	-	(866,241)
Endowment net assets, June 30, 2017	<u>\$ 13,721,271</u>	<u>\$ 3,043,412</u>	<u>\$ 2,828,294</u>	<u>\$ 19,592,977</u>
	2016			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, June 30, 2015	\$ 14,759,310	\$ 3,131,038	\$ 2,828,294	\$ 20,718,642
Investment return				
Investment income	103,278	24,346	-	127,624
Net depreciation realized and unrealized	(995,352)	(279,471)	-	(1,274,823)
Total investment return	(892,074)	(255,125)	-	(1,147,199)
Contributions	545,196	99,647	-	644,843
Appropriation for expenditure	(753,071)	-	-	(753,071)
Endowment net assets, June 30, 2016	<u>\$ 13,659,361</u>	<u>\$ 2,975,560</u>	<u>\$ 2,828,294</u>	<u>\$ 19,463,215</u>

Funds with Deficiencies - From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or UPMIFA requires the Agency to retain as a fund of perpetual duration. In accordance with GAAP, deficiencies of this nature that are reported in unrestricted net assets was \$0 and \$778 as of June 30, 2017 and 2016, respectively. These deficiencies resulted from unfavorable market fluctuations that occurred after the investment of new permanently restricted contributions. Subsequent gains that restore the fair value of the assets of the endowment fund to the required level will be classified as an increase in unrestricted net assets.

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended June 30, 2017 and 2016

NOTE 19 - Endowment Funds (cont.)

Return Objectives and Risk Parameters - The Agency has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to Agency programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the Agency must hold in perpetuity or for a donor-specified period(s) as part of board-designated funds. Under this policy, as approved by the governing board, the endowment assets are invested in a manner that is intended to produce results that exceed 5% annually while assuming a moderate level of investment risk.

Strategies Employed for Achieving Objectives - To satisfy its long-term rate-of-return objectives, the Agency relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Agency targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

Spending Policy and How the Investment Objectives Relate to Spending Policy - The Agency has a policy of appropriating for distribution each year 4-5% of its endowment fund's average fair value of applicable assets over the lower of the prior 4 or 12 quarters through the calendar year-end preceding the fiscal year in which the distribution is appropriated. In establishing this policy, the Agency considered the long-term expected return on its endowment. Accordingly, over the long term, the Agency expects the current spending policy to allow its endowment to grow at an average of approximately 3% annually. This is consistent with the Agency's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment return.

NOTE 20 - Lease Agreements

The Agency has entered into lease agreements for land and buildings, under which rental expense for 2017 and 2016 was \$1,287,111 and \$1,689,138, respectively.

Minimum future rental commitments for all operating leases in effect as of June 30, 2017, and the lease entered into related to the building in September 2017 (Note 1 - Property Held for Sale) are summarized as follows:

2018	\$ 1,532,415
2019	1,345,097
2020	1,362,764
2021	1,336,178
2022	1,034,920
Thereafter	<u>1,522,753</u>
Total	<u>\$ 8,134,127</u>

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended June 30, 2017 and 2016

NOTE 20 - Lease Agreements (continued)

Significant clauses contained in the lease agreements include the following:

- Escalation clauses not exceeding 5% on any given lease,
- Sharing of operation and maintenance costs,
- Ability to cancel a lease if funding for the related program is insufficient,
- Various options to extend the lease term, and
- Liability insurance requirements.

Minimum lease payments exclude rentals under renewal options which, as of June 30, 2017, are not reasonably assured of being exercised.

NOTE 21 - Contingencies

The Agency is a defendant in various lawsuits. The final results of such litigation cannot be determined at this time. In the opinion of management, any ultimate liability in these lawsuits would either be within insurance limits or would have no adverse effect on the consolidated financial statements.

As an employer, the Agency is subject to allegations of violation of various laws relating to employment. The Agency's attorneys have advised management that, relative to currently pending complaints, no judgment can be formed as to the likelihood of an unfavorable outcome. Management expects no material liability will be incurred as a result of these complaints.

The grants received by the Agency are subject to audit, and the Agency could become liable for any expenditures disallowed upon audit. Management believes, however, that such disallowance, if any, would not be material.

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the Years Ended June 30, 2017 and 2016

NOTE 22 - Certain Concentrations

Receivables

As of June 30, the Agency's accounts receivable include amounts due from all sources as follows:

	2017	2016
Illinois Department of Public Aid	\$ 2,189,275	\$ 956,952
Illinois Department of Children and Family Services	3,173,196	1,870,371
Illinois Department on Aging	26,403	2,719,116
Illinois Department of Corrections	-	118,924
Illinois Department of Human Services	2,540,818	3,336,613
Chicago Department of Human Services	478,304	169,821
Managed HUD Projects	360,434	223,792
Medicare	83,402	108,072
Private Pay - Other Client Fees	690,963	258,619
Insurance - Managed Care	3,295,488	2,819,381
Other	324,670	299,229
Total	13,162,953	12,880,890
Less: Allowance for doubtful accounts	(2,912,824)	(3,143,019)
Accounts receivable, net of allowance	\$ 10,250,129	\$ 9,737,871

The Agency receives a significant portion of its revenue and other support from several government units. If these government units terminated their support of the Agency, the Agency's ability to provide the services described in Note 1 could be significantly reduced.

Concentrations of Credit

The Agency maintains its cash deposits at several financial institutions which, at times, may exceed federally insured limits of \$250,000. The Agency has not experienced any losses in such accounts and management believes it is not exposed to any significant credit risk on these deposits.

NOTE 23 - Subsequent Events

The Agency has evaluated subsequent events through November 7, 2017, which is the date that the consolidated financial statements were available to be issued, for events requiring disclosure or recording in the consolidated financial statements.

OTHER INDEPENDENT AUDITORS' REPORTS

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER
MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS

INDEPENDENT AUDITORS' REPORT

Board of Directors
Lutheran Social Services of Illinois
Des Plaines, Illinois

We have audited, in accordance with the 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 financial statements of Lutheran Social Services of Illinois (the "Agency"), which comprise the consolidated statement of financial position as of June 30, 2017, and the related consolidated statements of activities, cash flows and functional expenses and directly related program services revenue for the year then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated November 7, 2017.

Internal Control Over Financial Reporting

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

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Agency's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

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

Baker Tilly Virchow Krause, LLP

Milwaukee, Wisconsin
November 7, 2017

REPORT ON COMPLIANCE FOR THE MAJOR FEDERAL PROGRAM AND REPORT ON INTERNAL
CONTROL OVER COMPLIANCE REQUIRED BY THE UNIFORM GUIDANCE

INDEPENDENT AUDITORS' REPORT

Board of Directors
Lutheran Social Services of Illinois
Des Plaines, Illinois

Report on Compliance for the Major Federal Program

We have audited Lutheran Social Services of Illinois' (the "Agency") compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on the Agency's major federal program for the year ended June 30, 2017. The Agency's major federal program is identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs.

The Agency's basic consolidated financial statements include the operations of subsidiaries of the Agency, as identified in the notes to the schedule of expenditures of federal awards, which received federal awards that are not included in the Agency's schedule of expenditures of federal awards during the year ended June 30, 2017. Our audit, described below, did not include the operations of those entities because they have separate audits under the Uniform Guidance or do not require an audit under the Uniform Guidance.

Management's Responsibility

Management is responsible for compliance with federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal program.

Auditors' Responsibility

Our responsibility is to express an opinion on compliance for the Agency's major federal program 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). Those standards and the Uniform Guidance 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 program occurred. An audit includes examining, on a test basis, evidence about the Agency'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 the major federal program. However, our audit does not provide a legal determination of the Agency's compliance.

Opinion on the Major Federal Program

In our opinion, the Agency complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on its major federal program for the year ended June 30, 2017.

Other Matters

The results of our auditing procedures disclosed an instance of noncompliance, which is required to be reported in accordance with the Uniform Guidance and which is described in the accompanying schedule of findings and questioned costs as item 2017-001. Our opinion on the major federal program is not modified with respect to this matter.

The Agency's response to the noncompliance finding identified in our audit is described in the accompanying schedule of findings and questioned costs. The Agency's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

Report on Internal Control Over Compliance

Management of the Agency 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 the Agency's internal control over compliance with the types of requirements that could have a direct and material effect on the major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for the major federal 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 the Agency'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 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 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 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. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

Baker Tilly Virchow Krause, LLP

Milwaukee, Wisconsin
February 26, 2018

SUPPLEMENTARY INFORMATION

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
For the Year Ended June 30, 2017**

Federal Awards Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number	Pass-Through Grantor's Number	Federal Expenditures
U.S. DEPARTMENT OF AGRICULTURE			
Passed through the Illinois State Board of Education			
School Breakfast Program	10.553	05-016-120P-00	\$ 7,374
National School Lunch Program	10.555	05-016-120P-00	<u>11,835</u>
Total of Child Nutrition Cluster			19,209
Passed through the Illinois State Board of Education			
Child and Adult Care Food Program	10.558	05-016-120P-00	<u>97,615</u>
Total U.S. Department of Agriculture			<u>116,824</u>
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES			
Passed through the Illinois Department of Children and Family Services			
Promoting Safe & Stable Families	93.556	013005-116-6	3,120
Promoting Safe & Stable Families	93.556	013005-116-7	38,922
Promoting Safe & Stable Families	93.556	013005-204-6	10,561
Promoting Safe & Stable Families	93.556	013005-204-7	60,461
Promoting Safe & Stable Families	93.556	013005-422-6	9,696
Promoting Safe & Stable Families	93.556	013005-422-7	48,437
Promoting Safe & Stable Families	93.556	013005-804-6	3,092
Promoting Safe & Stable Families	93.556	013005-804-7	12,923
Promoting Safe & Stable Families	93.556	013005-805-6	12,247
Promoting Safe & Stable Families	93.556	013005-905-7	384,507
Promoting Safe & Stable Families	93.556	013005-907-6	3,791
Promoting Safe & Stable Families	93.556	013005-907-7	11,733
Promoting Safe & Stable Families	93.556	013005-909-6	4,513
Promoting Safe & Stable Families	93.556	013005-909-7	<u>18,744</u>
Total of CFDA 93.556			<u>622,747</u>
Passed through City of Chicago Department of Family and Support Services			
Child Care Mandatory and Matching Funds of the Child Care and Development Fund	93.596	28406	4,033
Passed through the Illinois Department of Human Services			
Child Care Development Block Grant	93.575	80408490-W	<u>8,459</u>
Total of CCDF Cluster			<u>12,492</u>
Passed through City of Chicago Department of Family and Support Services			
Head Start	93.600	32008	132,896
Head Start	93.600	33351	<u>654,169</u>
Total CFDA 93.600			<u>787,065</u>

See accompanying notes to schedule of expenditures of federal awards.

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (continued)
For the Year Ended June 30, 2017

Federal Awards Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number	Pass-Through Grantor's Number	Federal Expenditures
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES (continued)			
Passed through the Illinois Department of Human Services Social Services Block Grant	93.667	FCSUR01028	\$ <u>35,601</u>
Passed through the Illinois Department of Human Services Block Grants for Community Mental Health Services	93.958	45CVB00426	133,707
Block Grants for Community Mental Health Services	93.958	45CVB00425	<u>53,889</u>
Total CFDA 93.958			<u>187,596</u>
Passed through the Illinois Department of Human Services - Office of Alcoholism and Substance Abuse			
Block Grants for Prevention and Treatment of Substance Abuse **	93.959	FCSUP01856	116,035
Block Grants for Prevention and Treatment of Substance Abuse **	93.959	43CUC00176 & 43CUC00181	<u>1,312,092</u>
Total CFDA 93.959			<u>1,428,127</u>
Total U.S. Department of Health and Human Services			<u>3,073,628</u>
CORPORATION FOR NATIONAL AND COMMUNITY SERVICE			
Direct			
Retired and Senior Volunteer Program	94.002	16SRNIL004	<u>193,000</u>
Passed through the Illinois Department of Public Health			
AmeriCorps	94.006	67380011D	25,939
AmeriCorps	94.006	77380011E	<u>61,500</u>
Total of CFDA number 94.006			<u>87,439</u>
Total Corporation for National and Community Service			<u>280,439</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS			<u>\$ 3,470,891</u>

** Indicates program tested as a major program in 2017.

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

**NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
For the Year Ended June 30, 2017**

Basis of Presentation

The accompanying schedule of expenditures of federal awards (the "schedule") includes the federal award activity of the Agency, except as noted below, under programs of the federal government for the year ended June 30, 2017. The information in this schedule is presented in accordance with the 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"). Because the schedule presents only a selected portion of the operations of the Agency, it is not intended to and does not present the financial position, changes in net assets or cash flows of the Agency.

Expenditures for the following consolidated subsidiaries of the Agency are not included to meet the requirements of the cost principles contained in the Uniform Guidance because they have separate audits or are not required to have an audit under Uniform Guidance:

Assisi Homes - Downer Place, Inc.	Northwest Chicago Group Homes, Inc.
Aurora Senior Housing, Inc.	Our Savior's Senior Housing
Batavia Council on Aging, Inc.	Rochelle Senior Housing, Inc.
Deer Creek Manor, Inc.	Rolling Meadows Senior Living, Inc.
Dekalb Housing for the Handicapped, Inc.	Salem Village III, Inc.
Fox Hill Senior Housing, Inc.	Spring Ridge Housing for Seniors, Inc.
Freeport Senior Housing, Inc.	Tabor Lutheran Senior Housing, Inc.
Freeport Senior Housing II, Inc.	Victorian Woods Senior Living
Luther Center, Inc.	

Summary of Significant Accounting Policies

Expenditures reported on the schedule are reported on the cash basis of accounting. Such expenditures are recognized following the cost principles contained in the Uniform Guidance, wherein certain types of expenditures are not allowable or are limited as to reimbursement. Negative amounts shown on the schedule represent adjustments or credits made in the normal course of business to amounts reported as expenditures in prior years. Pass-through entity identifying numbers are presented where available.

Indirect Cost Rate

The Agency has not elected to use the 10-percent de minimis indirect cost rate allowed under the Uniform Guidance.

Subrecipients

The Agency provided no federal awards to subrecipients.

Federal Loan Programs

The awards presented in the schedule do not include any federal loans administered by the Agency.

Non-Cash Assistance

The Agency did not receive any non-cash federal awards.

Federal Insurance

The awards presented in the schedule do not include any federal insurance in effect during 2017.

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS
For the Year Ended June 30, 2017**

Section I: Summary of Auditors' Results

Financial Statements

Type of report the auditors issued on whether the financial statements audited were prepared in accordance with GAAP:	unmodified		
Internal control over financial reporting:			
Material weakness(es) identified?	_____ yes	_____ <u>X</u> _____ no	_____ none reported
Significant deficiency(ies) identified?	_____ yes	_____ <u>X</u> _____	_____ reported
Noncompliance material to financial statements noted?	_____ yes	_____ <u>X</u> _____	_____ no

Federal Awards

Internal control over major federal programs:			
Material weakness(es) identified?	_____ yes	_____ <u>X</u> _____	_____ none reported
Significant deficiency(ies) identified	_____ yes	_____ <u>X</u> _____	_____ reported
Type of auditors' report issued on compliance for major federal programs:	unmodified		
Any audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516(a)?	_____ <u>X</u> _____	_____ yes	_____ no

Identification of major federal programs:

<u>CFDA Number</u>	<u>Name of Federal Program or Cluster</u>
--------------------	---

93.959

Block Grants for Prevention and Treatment of Substance Abuse

Dollar threshold used to distinguish between Type A and Type B programs

\$ 750,000

Auditee qualified as low-risk auditee?

_____ X _____ yes _____ no

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)
For the Year Ended June 30, 2017

Section II: Financial Statement Findings

There were no findings.

Section III: Federal Findings and Questioned Costs

2017-001

Agency: U.S. Department of Health and Human Services passed through City of Chicago Department of Family and Support Services

CFDA Number and Program Name: 93.600 - Head Start

Criteria: The grantor requires the Agency to comply with the requirements of the program which include the requirement that 10% of funded Head Start enrollment be provided to children with disabilities.

Statement of Condition: The Agency did not comply with the requirement that 10% of funded Head Start enrollment must be provided to children with disabilities.

Questioned Costs: The amount of questioned costs cannot be determined.

Context: Management identified that the Agency was not in compliance. As a result, management submitted reports to the funder communicating that the requirement was not met and is implementing plans to correct the condition.

Effect: The Agency is not in compliance with the earmarking requirement of the grant.

Cause: The Agency was not able to enroll enough participants with disabilities to meet the 10% requirement.

This is a repeat finding (prior year 2016-001).

Recommendation: We recommend management continue to work with their funders to amend the contract requirements and continue to advertise and promote the program to those with disabilities.

Management's Response: The Agency's Head Start program is committed to providing care and services to all eligible families and children, including those with disabilities. The plan to address the 10% of funding to be provided to children with disabilities is as follows:

- LSSI has an ongoing implementation plan to meet the federal mandate of having 10% of children with disabilities.
- LSSI staff work with the Chicago Public Schools(CPS) and families to identify children in need. Some of these children, after screenings, are determined not eligible for services and some families also decline further evaluations. For the upcoming year, we will work more diligently with parents to understand the value of early intervention and ensure we have strong referral for and individual education plan (IEP) that CPS will not deem unqualified for services.
- Staff were trained in August 2017 and February 2018 regarding timely observing and screening of children and how to interpret the screenings and working with families.
- A translation company was contracted to support children and families with diverse languages.
- Recruitment letters were sent out in September 2017 and January 2018 to reach out to other organizations and schools that with families with special needs children to develop partnerships.

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

**SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
For the Year Ended June 30, 2017**

2016-001

Agency: U.S. Department of Health and Human Services passed through City of Chicago Department of Family and Support Services

CFDA Number and Program Name: 93.600 - Head Start

Criteria: The grantor requires the Agency to comply with the requirements of the program which include the requirement that 10% of funded Head Start enrollment be provided to children with disabilities.

Statement of Condition: The Agency did not comply with the requirement that 10% of funded Head Start enrollment must be provided to children with disabilities.

Questioned Costs: The amount of questioned costs cannot be determined.

Context: Management identified that the Agency was not in compliance. As a result, management submitted reports to the funder communicating that the requirement was not met, along with a corrective action plan.

Effect: The Agency is not in compliance with the earmarking requirement of the grant.

Cause: The Agency was not able to enroll enough participants with disabilities to meet the 10% requirement.

Recommendation: We recommend management continue to work with their funders to amend the contract requirements and continue to advertise and promote the program to those with disabilities.

Management's Response: The Agency's Head Start program is committed to providing care and services to all eligible families and children, including those with disabilities. The plan to address the 10% of funding to be provided to children with disabilities is as follows:

- Support teaching staff in identifying and suspecting children who may have special needs as indicated by the developmental screening tool, classroom observations and parental concerns. Ensure all screenings are completed within the 45 day mandate and follow-up with referred children immediately. Screenings are monitored every other week to ensure the 45 days are met.
- Continue recruiting children with special needs by reaching out to organizations and schools that work with families with special needs children. On a quarterly basis, the Agency will send out recruitment letters and develop partnerships with the local Child and Family Connection Agency.
- Assist in professional development of staff to help support teachers in screening children on a timely basis and correctly identify concerns over the referral process.

These are the plans we are implementing to ensure that we meet our federal mandate of having 10% of our enrollment being made up of children with disabilities. We anticipate the Agency will be in compliance in 2017.

This finding has been repeated as finding 2017-001.



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Summary Schedule of Audit Findings
For Year Ended June 30, 2017

Finding 2017-001

93.600 Head Start

– The organization did not comply with requirement that 10% of funded Head Start enrollment must be provided to children with disabilities.

Status – Correction Action in Progress

Corrective Action – the program is committed to meeting our compliance obligations. The action plan is as follows

Lutheran Social Services of Illinois' Head Start program is committed to providing care and services to all eligible families and children, including those with disabilities. The plan to address the 10% of funding to be provided to children with disabilities is as follows:

- LSSI has an ongoing implementation plan to meet the federal mandate of having 10% of children with disabilities. The number of children with disabilities that LSSI was responsible for during FY2017 was 14. We have referred at least 12 children to CPS for services, 3 of the children are still awaiting evaluation dates, 3 children were not founded as needing services, 4 parents declined services and 4 children have received IEP for special services.
- LSSI staff work with the Chicago Public Schools (CPS) and families to identify children in need. Some of these children, after screenings, are determined not eligible for services and some families also decline further evaluations. For the upcoming year, we will work more diligently with parents to understand the value of early intervention and ensure we have strong referral for and individual education plan (IEP) that CPS will not deem unqualified for services.
- Staff were trained in August 2017 and February 2018 regarding timely observing and screening of children and how to interpret the screenings and working with families.
- A translation company was contracted to support children and families with diverse languages.
- Recruitment letters were sent out in September 2017 and January 2018 to reach out to other organizations and schools that with families with special needs children to develop partnerships.
- The program director is working closely with the disabilities coordinator to ensure consents are signed and referrals continue to be processed in a timely manner.

Prepared by:

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