The Arc of San Diego

THE ARC OF SAN DIEGO AND

ARC SAN DIEGO FOUNDATION

CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2017 AND 2016

Leaf & Cole, LLP
Certified Public Accountants

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ARC SAN DIEGO FOUNDATION
CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2017 AND 2016

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Leaf & Cole, LLP
Certified Public Accountants
A Partnership of Professional Corporations

Independent Auditor's Report

To the Board of Trustees
The Arc of San Diego and Arc San Diego Foundation
San Diego, California

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of The Arc of San Diego and Arc San Diego Foundation, which comprise the consolidated statements of financial position as of June 30, 2017 and 2016, and the related consolidated statements of activities, functional expenses and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to 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.

2810 Camino Del Rio South, Suite 200, San Diego, California 92108-3820
619.294.7200, 619.294.7077 fax, www.leaf-cole.com, leafcole@leaf-cole.com

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of The Arc of San Diego and Arc San Diego Foundation as of June 30, 2017 and 2016, and the changes in their net assets and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Leaf & Cole LLP

San Diego, California
October 25, 2017

THE ARC OF SAN DIEGO AND
ARC SAN DIEGO FOUNDATION
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
JUNE 30, 2017 AND 2016

ASSETS

	2017	2016
Current Assets: (Notes 2, 3, 4, 5 and 6)		
Cash and cash equivalents	$ 2,429,764	$ 3,474,759
Accounts receivable, net	3,352,689	2,625,872
Pledges receivable	16,875	60,900
Investments	7,465,257	8,812,864
Prepaid expenses	158,034	216,973
Deposit and other assets	148,603	74,137
Total Current Assets	13,571,222	15,265,505
Noncurrent Assets: (Notes 2, 3, 5, 7, 8 and 9)		
Pledges receivable	8,500	24,900
Deposits and other assets	27,500	27,500
Property and equipment, net	16,699,809	16,715,853
Charitable remainder trust	650,547	567,262
Beneficial interest in endowment funds	1,008,085	934,234
Total Noncurrent Assets	18,394,441	18,269,749
TOTAL ASSETS	$ 31,965,663	$ 33,535,254

LIABILITIES AND NET ASSETS

	2017	2016
Current Liabilities: (Notes 2 and 15)		
Accounts payable	$ 597,273	$ 1,150,660
Accrued expenses	4,576,968	3,783,393
Unearned revenue	195,063	68,567
Accrued compensated absences	841,786	846,302
Security deposits	588	588
Total Current Liabilities	6,211,678	5,849,510
Commitments and Contingencies (Notes 6, 10, 11, 15 and 16)		
Net Assets: (Notes 2, 13 and 14)		
Unrestricted	22,618,972	24,306,906
Temporarily restricted	2,126,928	2,444,604
Permanently restricted	1,008,085	934,234
Total Net Assets	25,753,985	27,685,744
TOTAL LIABILITIES AND NET ASSETS	$ 31,965,663	$ 33,535,254

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

THE ARC OF SAN DIEGO AND
ARC SAN DIEGO FOUNDATION
CONSOLIDATED STATEMENTS OF ACTIVITIES
FOR THE YEARS ENDED JUNE 30, 2017 AND 2016

	2017				2016			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenue and Support:								
San Diego Regional Center	$ 16,807,505	$ -	$ -	$ 16,807,505	$ 15,062,298	$ -	$ -	$ 15,062,298
Services to the public	10,460,100	-	-	10,460,100	10,163,407	-	-	10,163,407
Medi-Cal	4,348,202	-	-	4,348,202	4,425,788	-	-	4,425,788
Workshop sales	917,182	-	-	917,182	939,351	-	-	939,351
Contributions	95,909	204,074	4,474	304,457	104,970	618,640	5,871	729,481
Other service contracts	245,093	-	-	245,093	563,041	-	-	563,041
Department of rehabilitation	343,354	-	-	343,354	344,060	-	-	344,060
Fundraising/special events	286,900	-	-	286,900	287,865	-	-	287,865
Other revenue	210,186	-	-	210,186	258,592	-	-	258,592
Investment return	799,437	-	112,423	911,860	76,374	-	(15,603)	60,771
Memberships	29,820	-	-	29,820	35,736	-	-	35,736
Rental income	9,298	-	-	9,298	9,792	-	-	9,792
Gain on sale of property and equipment	16,788	-	-	16,788	1,338	-	-	1,338
Change in value of charitable remainder trust	-	83,285	-	83,285	-	(29,233)	-	(29,233)
Net assets released from restrictions	648,081	(605,035)	(43,046)	-	1,445,429	(1,402,127)	(43,302)	-
Total Revenue and Support	35,217,855	(317,676)	73,851	34,974,030	33,718,041	(812,720)	(53,034)	32,852,287
Expenses:								
Program Services:								
Work activity vocational services	16,301,641	-	-	16,301,641	14,926,569	-	-	14,926,569
Adult activity	7,835,228	-	-	7,835,228	6,894,054	-	-	6,894,054
Community living services	5,743,976	-	-	5,743,976	5,688,978	-	-	5,688,978
Respite services	1,370,673	-	-	1,370,673	1,190,080	-	-	1,190,080
Infant programs	879,306	-	-	879,306	758,886	-	-	758,886
Special Programs	313,540	-	-	313,540	311,887	-	-	311,887
Total Program Services	32,444,364	-	-	32,444,364	29,770,454	-	-	29,770,454
Supporting Services:								
Management and general	4,093,233	-	-	4,093,233	4,032,158	-	-	4,032,158
Fundraising and Chapter	238,981	-	-	238,981	240,897	-	-	240,897
Total Supporting Services	4,332,214	-	-	4,332,214	4,273,055	-	-	4,273,055
Total Program and Supporting Services	36,776,578	-	-	36,776,578	34,043,509	-	-	34,043,509
Special Events	129,211	-	-	129,211	146,966	-	-	146,966
Total Expenses	36,905,789	-	-	36,905,789	34,190,475	-	-	34,190,475
Change in Net Assets	(1,687,934)	(317,676)	73,851	(1,931,759)	(472,434)	(812,720)	(53,034)	(1,338,188)
Net Assets at Beginning of Year	24,306,906	2,444,604	934,234	27,685,744	24,779,340	3,257,324	987,268	29,023,932
NET ASSETS AT END OF YEAR	$ 22,618,972	$ 2,126,928	$ 1,008,085	$ 25,753,985	$ 24,306,906	$ 2,444,604	$ 934,234	$ 27,685,744

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

THE ARC OF SAN DIEGO AND
ARC SAN DIEGO FOUNDATION
CONSOLIDATED STATEMENTS OF FUNCTIONAL EXPENSES
FOR THE YEAR ENDED JUNE 30, 2017

	Program Services							Supporting Services			
	Work Activity Vocational Services	Adult Activity	Community Living Services	Respite Services	Infant Programs	Special Programs	Total Program Services	Management and General	Fundraising and Chapter	Total Supporting Services	Total Program and Supporting Services
Personnel Expenses:											
Salaries and wages	$ 6,422,829	$ 4,480,049	$ 3,124,814	$ 877,028	$ 554,818	$ 115,748	$ 15,575,286	$ 2,208,327	$ 121,748	$ 2,330,075	$ 17,905,361
Health and welfare benefits	3,125,720	1,335,261	979,291	115,326	160,817	16,275	5,732,690	546,145	23,132	569,277	6,301,967
Payroll taxes	574,340	395,416	276,553	77,568	49,595	9,008	1,382,480	187,511	9,314	196,825	1,579,305
Employee benefits	89,789	58,986	48,716	13,555	3,697	4,742	219,485	110,408	4,364	114,772	334,257
Total Personnel Expenses	10,212,678	6,269,712	4,429,374	1,083,477	768,927	145,773	22,909,941	3,052,391	158,558	3,210,949	26,120,890
Non-Personnel Expenses:											
Direct production and contract costs	5,065,427	240,136	28,885	1,098	-	739	5,336,285	45,149	-	45,149	5,381,434
Occupancy	466,248	676,510	344,834	18,722	20,988	57,603	1,584,905	117,562	-	117,562	1,702,467
Vehicle and travel	200,359	210,998	275,212	198,183	26,574	4,865	916,191	80,503	-	80,503	996,694
Program supplies and expenses	59,287	196,996	292,561	11,174	21,270	97,973	679,261	1,877	-	1,877	681,138
Professional fees	129,505	74,596	97,279	22,197	32,062	1,200	356,839	240,628	1,238	241,866	598,705
Office supplies and expenses	85,458	60,856	35,519	4,926	8,813	3,223	198,795	212,524	431	212,955	411,750
Dues and assessments	-	-	233,857	300	-	1,732	235,889	77,187	-	77,187	313,076
Repairs and maintenance	72,997	89,619	5,136	4,053	300	182	172,287	75,581	-	75,581	247,868
Other expenses/refunds	679	10,025	(494)	-	13	192	10,415	59,488	75,259	134,747	145,162
Advertising and promotion	8,236	3,113	484	58	58	58	12,007	93,693	3,495	97,188	109,195
Bad debt expense	-	-	-	25,884	-	-	25,884	31,972	-	31,972	57,856
Recruitment advertisement	767	1,956	1,329	601	301	-	4,954	4,471	-	4,471	9,425
Interest expense	-	711	-	-	-	-	711	207	-	207	918
Total Non-Personnel Expenses	6,088,963	1,565,516	1,314,602	287,196	110,379	167,767	9,534,423	1,040,842	80,423	1,121,265	10,655,688
Total Program and Supporting Services Expenses	$ 16,301,641	$ 7,835,228	$ 5,743,976	$ 1,370,673	$ 879,306	$ 313,540	$ 32,444,364	$ 4,093,233	$ 238,981	$ 4,332,214	$ 36,776,578

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

THE ARC OF SAN DIEGO AND
ARC SAN DIEGO FOUNDATION
CONSOLIDATED STATEMENTS OF FUNCTIONAL EXPENSES
FOR THE YEAR ENDED JUNE 30, 2016

	Program Services							Supporting Services			
	Work Activity Vocational Services	Adult Activity	Community Living Services	Respite Services	Infant Programs	Special Programs	Total Program Services	Management and General	Fundraising and Chapter	Total Supporting Services	Total Program and Supporting Services
Personnel Expenses:											
Salaries and wages	$ 5,974,334	$ 3,853,113	$ 3,045,645	$ 770,591	$ 473,200	$ 118,791	$ 14,235,674	$ 2,182,035	$ 121,748	$ 2,303,783	$ 16,539,457
Health and welfare benefits	2,503,447	1,239,617	744,456	93,046	139,393	14,998	4,734,957	472,224	23,132	495,356	5,230,313
Payroll taxes	498,531	310,901	247,190	62,570	38,494	8,918	1,166,604	167,458	9,314	176,772	1,343,376
Employee benefits	94,622	72,302	44,761	8,781	5,129	6,709	232,304	114,869	10,186	125,055	357,359
Total Personnel Expenses	9,070,934	5,475,933	4,082,052	934,988	656,216	149,416	20,369,539	2,936,586	164,380	3,100,966	23,470,505
Non-Personnel Expenses:											
Direct production and contract costs	4,809,937	175,405	35,710	387	-	226	5,021,665	32,182	-	32,182	5,053,847
Occupancy	437,920	565,767	568,832	17,581	18,608	54,388	1,663,096	126,901	-	126,901	1,789,997
Vehicle and travel	229,443	242,721	276,266	196,130	30,242	13,967	988,769	86,719	-	86,719	1,075,488
Program supplies and expenses	45,165	216,420	335,952	10,699	14,305	83,683	706,224	-	31	31	706,255
Professional fees	133,846	67,365	100,353	21,988	29,921	1,403	354,876	227,262	-	227,262	582,138
Office supplies and expenses	106,699	73,683	45,291	5,477	9,315	4,048	244,513	281,583	366	281,949	526,462
Dues and assessments	-	220	216,697	625	-	1,698	219,240	77,705	-	77,705	296,945
Repairs and maintenance	81,909	73,130	24,383	2,205	279	170	182,076	71,810	-	71,810	253,886
Other expenses/refunds	4,135	1,470	2,025	-	-	386	8,016	51,122	74,246	125,368	133,384
Advertising and promotion	6,546	944	-	-	-	135	7,625	107,125	1,874	108,999	116,624
Bad debt expense	-	-	-	-	-	-	-	27,937	-	27,937	27,937
Recruitment advertisement	35	996	1,417	-	-	2,367	4,815	4,655	-	4,655	9,470
Interest expense	-	-	-	-	-	-	-	571	-	571	571
Total Non-Personnel Expenses	5,855,635	1,418,121	1,606,926	255,092	102,670	162,471	9,400,915	1,095,572	76,517	1,172,089	10,573,004
Total Program and Supporting Services Expenses	$ 14,926,569	$ 6,894,054	$ 5,688,978	$ 1,190,080	$ 758,886	$ 311,887	$ 29,770,454	$ 4,032,158	$ 240,897	$ 4,273,055	$ 34,043,509

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

THE ARC OF SAN DIEGO AND
ARC SAN DIEGO FOUNDATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2017 AND 2016

	2017	2016
Cash Flows From Operating Activities:		
Change in net assets	$ (1,931,759)	$ (1,338,188)
Adjustments to reconcile change in net assets to net cash (used in) provided by operating activities:		
Depreciation	800,889	703,745
Allowance for doubtful accounts	34,686	(63,104)
Realized and unrealized (gains) losses on investments	(592,641)	207,362
Gain on sale of property and equipment	(16,788)	(1,338)
Change in value of charitable remainder trust	(83,285)	29,233
Permanently restricted contributions	(4,474)	(5,871)
Permanently restricted investment (gains) losses	(112,423)	15,603
Permanently restricted distributions	43,046	43,302
(Increase) Decrease in:		
Accounts receivable	(761,503)	967,111
Pledges receivable	60,425	(85,800)
Prepaid expenses, deposits, and other assets	(15,527)	(89,498)
Increase (Decrease) in:		
Accounts payable	(434,723)	(333,550)
Accrued expenses	793,575	36,095
Unearned revenue	126,496	(1,580)
Accrued compensated absences	(4,516)	12,954
Net Cash (Used in) Provided by Operating Activities	(2,098,522)	96,476
Cash Flows From Investing Activities:		
Purchase of property and equipment	(903,509)	(4,185,143)
Proceeds from sale of property and equipment, net	16,788	2,227
Sales and (purchases) of investments, net	1,940,248	(506,141)
Change in beneficial interest in endowment funds	(73,851)	53,034
Net Cash Provided by (Used in) Investing Activities	979,676	(4,636,023)
Cash Flows From Financing Activities:		
Permanently restricted contributions	4,474	5,871
Permanently restricted investment (losses) gains	112,423	(15,603)
Permanently restricted distributions	(43,046)	(43,302)
Net Cash Provided by (Used in) Financing Activities	73,851	(53,034)
Net Decrease in Cash and Cash Equivalents	(1,044,995)	(4,592,581)
Cash and Cash Equivalents at Beginning of Year	3,474,759	8,067,340
CASH AND CASH EQUIVALENTS AT OF END OF YEAR	$ 2,429,764	$ 3,474,759
Supplemental Disclosure of Cash Flow Information:		
Cash paid for interest	$ 918	$ 571

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

Note 1 - Organization:

The Arc of San Diego

The Arc of San Diego is one of the largest, most comprehensive providers of services to children and adults with disabilities in San Diego County. The Arc of San Diego was founded in 1951 by parents and other community members who were concerned about the lack of services available for children with disabilities and their families. The Arc of San Diego provides assistance to approximately 2,500 children and adults with disabilities at sixteen locations throughout the county. Through The Arc of San Diego's programs, people with disabilities are able to obtain support in living independent and fulfilling lives.

The Arc of San Diego's mission is to support and empower persons with disabilities to achieve their life goals. Vocational training, job placement, employment opportunities, and programs for building daily living skills are offered countywide. The Arc of San Diego also offers residential living support, recreational activities, respite services, and early intervention programs for infants and toddlers. The Arc of San Diego is proud of the wide range of programs we offer to people with disabilities and their families. The Arc of San Diego's staff work in collaboration with other professionals such as speech therapists, psychologists, and nutritionists, as well as by partnering with community resources and other nonprofits to seek the best possible support for those served.

The Arc of San Diego is committed to securing the opportunity for people with disabilities to choose and realize their goals of where and how they live, work, and play in the community. The Arc of San Diego is committed to reducing the incidence and limiting the consequence of disabilities through education, research, advocacy, and the support of families, friends, staff, and community members. Through classes, workshops, community living, and individualized counseling, the dedicated staff at The Arc of San Diego patiently guides individuals with disabilities toward living the most self-sufficient life possible. The ultimate goal of all programs and services at The Arc of San Diego is to help each individual reach their highest level of independence.

Arc San Diego Foundation

Arc San Diego Foundation was incorporated under the laws of the state of California in 1992 for the purpose of obtaining and administering funds and other property to be used in furtherance of the purpose of The Arc of San Diego. Its principal sources of revenue are contributions from the general public and special events.

Note 2 - Significant Accounting Policies:

Consolidated Financial Statements

The consolidated financial statements include the accounts of The Arc of San Diego and Arc San Diego Foundation, which are collectively referred to as "The Arc". The sole member of the Arc San Diego Foundation is The Arc of San Diego. All material intercompany transactions have been eliminated in consolidation.

Note 2 - Significant Accounting Policies:(Continued)

Accounting Method

The financial statements of The Arc have been prepared on the accrual basis of accounting which is in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) and, accordingly, reflect all significant receivables, payables, and other liabilities.

Financial Statement Presentation

The consolidated financial statements present information regarding the financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets and permanently restricted net assets.

- Unrestricted net assets – Net assets not subject to donor imposed stipulations

- Temporarily restricted net assets – Net assets subject to donor imposed stipulations that will be met by actions of The Arc and/or the passage of time. When a donor stipulated time restriction ends or a purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions.

- Permanently restricted net assets – Net assets subject to donor imposed stipulations requiring that they be maintained permanently by The Arc. The income from these assets is available for either general operations or specific programs as specified by the donor.

The FASB has issued reporting standards for endowments of not-for-profit Organizations subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act (UPMIFA), and enhanced disclosures for all endowment funds. The standards provide guidance on classifying the net assets associated with donor-restricted endowment funds held by organizations that are subject to an enacted version of UPMIFA, which serves as a model act for states to modernize their laws governing donor-restricted endowment funds. The standards also require additional disclosures about endowments (both donor-restricted funds and board-designated funds) to enable users of financial statements to understand the net asset classification, net asset composition, changes in net asset composition, spending policies, and related investment policies of its endowment funds.

Estimates

The preparation of 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 financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Risks and Uncertainties

The Arc invests in various types of investment securities which are exposed to various risks, such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and such changes could materially affect the amounts reported in the consolidated statements of financial position.

Note 2 - Significant Accounting Policies:(Continued)

Fair Value Measurements

Fair value accounting standards define fair value, establish a framework for measuring fair value, outline a fair value hierarchy based on inputs used to measure fair value and enhance disclosure requirements for fair value measurements. The fair value hierarchy distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within Level 1 or 2 of the hierarchy) and the reporting entity's own assumptions about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy).

- Level 1 inputs are quoted prices in active markets for identical investments that the investment manager has the ability to access at the measurement date.

- Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the investment, either directly or indirectly.

- Level 3 inputs are unobservable inputs for the investment.

The Arc's consolidated statements of financial position includes the following financial instruments that are required to be measured at fair value on a recurring basis:

- Investments in mutual funds and common stock are considered Level 1 assets and are reported at fair value based on quoted prices in active markets for identical assets at the measurement date.

- The charitable remainder trust is considered a Level 3 asset and is reported at fair value based on management's assumptions about the expected investment return on the underlying trust assets, an applicable discount rate and the life expectancy of the donor. (Note 8)

- The beneficial interest in endowment funds held by San Diego Foundation ("SDF") is considered a Level 3 asset and is reported at fair value based on values provided by SDF. SDF determines the fair values based on the unit value of The Arc's interest in the pools in which it has invested. The unit value is based on the fair value of the underlying assets in the pools. (Note 9)

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable consist of amounts due to The Arc for services provided through June 30 that have not yet been collected. Amounts are generally considered past due if not collected within 30 days of billings. Interest is not charged on outstanding balances.

Bad debts are recognized on the allowance method based on historical experience and management's evaluation of outstanding receivables. The allowance for doubtful accounts receivable totaled $108,513 and $73,827 at June 30, 2017 and 2016, respectively. The allowance for doubtful pledges receivable is based on historical experience and management's evaluation of the collectability of individual pledges receivable. Management believes that all pledges receivable are fully collectible; therefore, no allowance for doubtful pledges receivable was recorded at June 30, 2017 and 2016.

Note 2 - Significant Accounting Policies:(Continued)

Capitalization and Depreciation

The Arc capitalizes all expenditures in excess of $10,000 for property and equipment at cost, while donations of property and equipment are recorded at their estimated fair values. Such donations are reported as unrestricted 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. Absent donor stipulations regarding how long those donated assets must be maintained, The Arc reports expirations of donor restrictions when the donated or acquired assets are placed in service as instructed by the donor. The Arc reclassifies temporarily restricted net assets to unrestricted net assets at that time.

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

Buildings and improvements	5-50 years
Vehicles	5 years
Equipment, furniture and fixtures	3-10 years

Depreciation totaled $800,889 and $703,745 for the years ended June 30, 2017 and 2016, respectively.

Maintenance and repairs are charged to operations as incurred. Upon sale or disposition of property or equipment, the asset account is reduced by the cost and the accumulated depreciation account is reduced by the depreciation taken prior to the sale. Any resultant gain or loss is then recorded as income or expense.

Impairment of Long-Lived Assets

The Arc reviews its long-lived assets for impairment whenever events and changes in circumstances indicate that the carrying value of such property may not be recoverable. Recoverability is measured by a comparison of the carrying amount of the real estate to the estimated proceeds from the eventual disposition of the real estate. If the real estate is considered to be impaired, the impairment to be recognized is measured at the amount by which the carrying amount of real estate exceeds the fair value of such property. There were no impairment losses recognized in 2017 and 2016.

Compensated Absences

Accumulated unpaid vacation and sick leave (for employees hired before 1996) totaling $841,786 and $846,302 at June 30, 2017 and 2016, respectively, is accrued when incurred.

Note 2 - Significant Accounting Policies:(Continued)

Revenue Recognition

San Diego Regional Center, Services to the Public, Medi-Cal, Workshop Sales, Other Revenue, Other Service Contracts, Department of Rehabilitation and Rental Income

Revenue is recognized when services are provided.

Memberships

Revenue is recognized as nonrefundable payments are received.

Unearned Revenue

Amounts received prior to performing services are recorded as unearned revenue. Unearned revenue totaled $195,063 and $68,567 at June 30, 2017 and 2016, respectively.

Contributions

Contributions are recognized when the donor makes a promise to give in writing to The Arc that is in substance, unconditional. Conditional promises to give are not recognized until they become unconditional, that is, when the conditions on which they depend are substantially met. Contributions are recorded as unrestricted, temporarily restricted, or permanently restricted support, depending on the existence or nature of any donor restrictions. All donor-restricted support is reported as an increase in temporarily restricted net assets. When the stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets. Contributions to be received in future periods are discounted at an appropriate discount rate. Amortization of discounts is recorded as additional contribution revenue in accordance with donor-imposed restrictions, if any, on the contributions.

Donated Services and Support

The Arc utilizes the services of many volunteers throughout the year. This contribution of services by the volunteers is not recognized in the financial statements unless the services received (a) create or enhance nonfinancial assets or (b) require specialized skills which are provided by individuals possessing those skills and would typically need to be purchased if not provided by donation. The donated services for the years ended June 30, 2017 and 2016, did not meet the requirements above, therefore no amounts were recognized in the financial statements.

Functional Allocation of Expenses

The costs of providing the various programs and other activities have been summarized on a functional basis in the consolidated statements of activities. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

Note 2 - Significant Accounting Policies:(Continued)

Income Taxes

The Arc of San Diego and Arc San Diego Foundation are nonprofit California corporations. Both organizations are exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code and Section 23701(d) of the California Revenue and Taxation Code, except to the extent of unrelated business taxable income. For the years ended June 30, 2017 and 2016, no provision for unrelated business taxes is required. The Arc of San Diego and Arc San Diego Foundation believe that they have appropriate support for any tax positions taken, and as such, do not have any uncertain tax positions that are material to the consolidated financial statements. The Arc of San Diego and Arc San Diego Foundation are not private foundations.

The Arc of San Diego and Arc San Diego Foundation Returns of Organization Exempt from Income Tax for the years ended June 30, 2017, 2016, 2015 and 2014 are subject to examination by the Internal Revenue Service and State taxing authorities, generally three to four years after the returns were filed.

Concentrations

Cash and Cash Equivalents

The Arc maintains its cash in bank deposit accounts which exceed federally-insured deposit limits. The Arc has not experienced any losses in such accounts.

For purposes of the consolidated statements of cash flows, The Arc considers all highly liquid investments available for current use with an initial maturity of three months or less to be cash equivalents.

State of California Funding

The Arc depends significantly on revenue received from state of California (the “State”) agencies, including the San Diego Regional Center and Medi-Cal. The State operates within a budget environment that could impact the State’s cash flows, its ability to pay vendors, and its ability to continue funding programs. Consequently, due to the significance of revenue generated from the State and Medi-Cal agreements, The Arc is subject to a risk that it will not receive timely payment from the State for services provided under these agreements and that funding cuts may occur.

Services to the Public

Included in revenue from services to the public is approximately $7,560,000 and $7,388,000 for the years ended June 30, 2017 and 2016, respectively, earned from one company, which represents approximately 72% and 73% of total services to the public revenue for the years then ended, respectively.

Included in accounts receivable for services to the public is approximately $890,000 and $591,000 due from one company at June 30, 2017 and 2016, respectively, which represents approximately 62% and 64% of total receivables from these contracts, respectively.

Note 2 - Significant Accounting Policies:(Continued)

Subsequent Events

The Arc has evaluated subsequent events through October 25, 2017, which is the date the consolidated financial statements are available for issuance, and concluded that there were no events or transactions that needed to be disclosed.

Note 3 - Fair Value Measurements:

The following table summarizes assets measured at fair value by classification within the fair value hierarchy at June 30:

	2017			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at June 30, 2017
Mutual funds:				
Domestic equity	$ 3,484,149	$ -	$ -	$ 3,484,149
Domestic fixed income	2,894,500	-	-	2,894,500
International equity	1,040,776	-	-	1,040,776
Common stock	45,832	-	-	45,832
Charitable remainder trust (Note 8)	-	-	650,547	650,547
Beneficial interest in endowment funds (Note 9)	-	-	1,008,085	1,008,085
	$ 7,465,257	$ -	$ 1,658,632	$ 9,123,889

	2016			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at June 30, 2016
Mutual funds:				
Domestic equity	$ 3,957,218	$ -	$ -	$ 3,957,218
Domestic fixed income	3,745,735	-	-	3,745,735
International equity	1,053,839	-	-	1,053,839
Common stock	56,072	-	-	56,072
Charitable remainder trust (Note 8)	-	-	567,262	567,262
Beneficial interest in endowment funds (Note 9)	-	-	934,234	934,234
	$ 8,812,864	$ -	$ 1,501,496	$ 10,314,360

The reconciliation for financial instruments measured at fair value on a recurring basis as significant unobservable inputs (Level 3) are included in the Notes as indicated above.

Note 3 - Fair Value Measurements: (Continued)

The following table represents The Arc's Level 3 financial instruments, the valuation techniques used to measure the fair value of the financial instruments, and the significant unobservable inputs and the range of values for those inputs for the years ended June 30:

2017

Instrument	Fair Value	Principal Valuation Technique	Unobservable Inputs	Significant Input Values
Beneficial interest in endowment funds	$ 1,008,085	Valuation of underlying assets as provided by San Diego Foundation	Base price	N/A
Charitable remainder trust	$ 650,547	Present value of expected cash flows	Investment yield	1.8%
			Discount rate	1.8%

2016

Instrument	Fair Value	Principal Valuation Technique	Unobservable Inputs	Significant Input Values
Beneficial interest in endowment funds	$ 934,234	Valuation of underlying assets as provided by San Diego Foundation	Base price	N/A
Charitable remainder trust	$ 567,262	Present value of expected cash flows	Investment yield	1.8%
			Discount rate	1.8%

Note 4 - Accounts Receivable:

Accounts receivable consists of the following at June 30:

	2017	2016
San Diego Regional Center	$ 1,463,659	$ 1,288,057
Contracts for services to the public	1,426,872	921,799
Medi-Cal	491,741	405,933
Department of Rehabilitation	77,555	60,786
Other receivables	1,375	23,124
Total Accounts Receivable	3,461,202	2,699,699
Less: Allowance for doubtful accounts	(108,513)	(73,827)
Accounts Receivable, Net	$ 3,352,689	$ 2,625,872

Note 5 - Pledges Receivable:

Pledges receivable consist of the following at June 30:

	2017	2016
Pledges due in less than one year	$ 16,875	$ 60,900
Pledges due in one to five years	8,500	24,900
Total Pledges Receivable	$ 25,375	$ 85,800

Note 6 - Investments:

Investments consist of the following at June 30:

	2017	2016
Mutual funds:		
Domestic equity	$ 3,484,149	$ 3,957,218
Domestic fixed income	2,894,500	3,745,735
International equity	1,040,776	1,053,839
Common stock	45,832	56,072
Total Investments	$ 7,465,257	$ 8,812,864

Cash and investments totaling $1,132,879 and $2,507,000 are pledged as collateral to secure the letter of credit for self-insured workers' compensation (Notes 11 and 15) at June 30, 2017 and 2016, respectively.

Investment return is summarized as follows for the years ended June 30:

	2017		
	Unrestricted	Permanently Restricted	Total
Interest and dividend income	$ 206,796	$ -	$ 206,796
Realized and unrealized gains	592,641	112,423	705,064
Total Investment Return	$ 799,437	$ 112,423	$ 911,860

	2016		
	Unrestricted	Permanently Restricted	Total
Interest and dividend income	$ 283,736	$ -	$ 283,736
Realized and unrealized losses	(207,362)	(15,603)	(222,965)
Total Investment Return	$ 76,374	$ (15,603)	$ 60,771

Note 7 - Property and Equipment:

Property and equipment consist of the following at June 30:

	2017	2016
Land	$ 2,413,317	$ 2,413,317
Buildings and improvements	22,058,380	20,082,006
Vehicles	1,859,031	1,808,438
Equipment, furniture and fixtures	840,074	864,000
Subtotal	27,170,802	25,167,761
Less: Accumulated depreciation	(10,813,139)	(10,117,495)
Construction in progress	342,146	1,665,587
Property and Equipment, Net	$ 16,699,809	$ 16,715,853

Note 8 - Charitable Remainder Trust:

The Arc is the beneficiary of an irrevocable charitable remainder trust (the "Trust") administered by a third party. The trust agreement requires the Trust to make periodic payments to the grantor over the grantor's lifetime. The Trust terminates upon the death of the grantor, at which time The Arc will receive the remaining trust assets.

The fair value of the future benefits to be received by The Arc was determined using a discounted cash flow model and was recorded in the consolidated statements of activities as temporarily restricted contributions in the year the trust was established. The fair value of the remainder interest at June 30, 2017 and 2016 is calculated using a discounted cash flow model using the fair value of the assets in the Trust as provided by the Trustee, a discount rate of approximately 1.8% in both years, and the life expectancy of the donor based on applicable mortality tables. The unobservable inputs used in the calculations are evaluated and adjusted, as necessary, annually by the Chief Financial Officer in conjunction with the Investment Committee. Increases (decreases) in the discount rate or life expectancy based on mortality tables would result in decreases (increases) in the fair value of the beneficial interest in the charitable remainder trust. An increase (decrease) in the fair value of the assets in the Trust will increase (decrease) the fair value of The Arc's beneficial interest.

The Trust is comprised of the following at June 30:

	2017	2016
Fair value of charitable remainder trust assets	$ 1,141,697	$ 1,076,790
Less: Discount to fair value	(491,150)	(509,528)
Charitable Remainder Trust, Net	$ 650,547	$ 567,262

Note 8 - Charitable Remainder Trust: (Continued)

The activity of the Trust consisted of the following for the years ended June 30:

	2017	2016
Balance at beginning of year	$ 567,262	$ 596,495
Change in discount and fair value	83,285	(29,233)
Balance at end of year	$ 650,547	$ 567,262

Note 9 - Beneficial Interest in Endowment Funds:

The Arc has a beneficial interest in endowment funds held at San Diego Foundation, which are classified as permanently restricted for these investments that must be maintained in perpetuity. The beneficial interest in endowment funds held at San Diego Foundation is invested in a portfolio of equity and debt securities, which is structured for long-term total return, consisting of 28% international equities, 24% domestic equities, 20% alternative investments, 17% fixed income, 7% real estate and 4% commodities. The Arc receives distributions of earnings on an annual basis. The Arc received $43,046 and $43,302 in distributions for the years ended June 30, 2017 and 2016, respectively.

The activity in the beneficial interest in endowment funds consisted of the following for the years ended June 30:

	2017	2016
Balance at beginning of year	$ 934,234	$ 987,268
Contributions	4,474	5,871
Investment gain (loss)	112,423	(15,603)
Distributions	(43,046)	(43,302)
Balance at end of year	$ 1,008,085	$ 934,234

Note 10 - Line of Credit:

The Arc has a line of credit with a bank in the amount of $1,000,000 at an interest rate of prime plus 0.75% (4.75% at June 30, 2017). There was no outstanding balance on the line of credit at June 30, 2017 and 2016. The line of credit expires on January 31, 2018 and is secured by property and equipment.

Note 11 - Letter of Credit:

The Arc has an irrevocable standby letter of credit to secure payment of insurance claims on its self-insured worker's compensation plan. The letter of credit stood at $1,132,879 and $2,507,000 at June 30, 2017 and 2016, respectively. The letter of credit is secured by a pledge of cash and investments (Note 6).

Note 12 - Defeased Certificates of Participation:

On June 23, 2015, The Arc sold its Crown Point properties, the proceeds of which were placed into an escrow account to provide for all future payments on the Certificates of Participation. As a result, the Certificates of Participation were defeased, and are not included in The Arc's financial statements at June 30, 2017 and 2016. The balance in the escrow account totaled $12,217,892 and $13,135,540 at June 30, 2017 and 2016, respectively.

Note 13 - Temporarily Restricted Net Assets:

Temporarily restricted net assets are available for the following purposes at June 30:

	2017	2016
Purpose restrictions:		
Undesignated capital and emergency needs	$ 1,447,401	$ 1,447,401
Programs	28,980	100,135
Capital campaign	-	329,806
Time restrictions:		
Charitable remainder trust	650,547	567,262
Total Temporarily Restricted Net Assets	$ 2,126,928	$ 2,444,604

Temporarily restricted net assets of $504,900 for the capital campaign and $100,135 for program support were released from restriction during the year ended June 30, 2017. Temporarily restricted net assets of $1,362,069 for the capital campaign and $40,058 for program support were released from restriction during the year ended June 30, 2016.

Note 14 - Endowment Net Assets:

The endowment funds of The Arc are held by San Diego Foundation ("SDF"). SDF manages the fund in accordance with UPMIFA. SDF's objective is to maintain the purchasing power (real value) of the endowment funds. However, from time to time, the fair value of the assets in the endowment fund may fall below the level that the donors require The Arc to retain as a fund of perpetual duration. The Arc classifies permanently restricted net assets held by SDF as:

- The original value of gifts donated to the fund
- The original value of The Arc funds transferred to the fund
- The original value of subsequent gifts donated to the fund
- Investment income and realized and unrealized gains and losses on investments
- Distributions from the fund in accordance with the spending policy

SDF has adopted investment and spending policies for endowment funds that:

- Protect the invested assets
- Preserve spending capacity of the fund income
- Maintain a diversified portfolio of assets that meet investment return objectives while keeping risk at a level commensurate with that of the median fund in comparable foundations
- Comply with applicable laws

Note 14 - Endowment Net Assets: (Continued)

SDF's endowment funds are invested in a diversified portfolio of equity and debt securities, which is structured for long-term total return. SDF's spending policy is to disburse 5% annually, based upon endowment principal market value over the last 36 months. These calculations are made on a monthly basis. If the market value of the Endowment Principal of any fund, at the end of each month, is less than the initial value of all contributions made to the Endowment Principal, then distributions will be limited to interest and dividends received.

Endowment composition by type of fund and changes in endowment net assets as of and for the years ended June 30:

Endowment Net Assets at June 30, 2015	$ 987,268
Contributions	5,871
Investment losses	(15,603)
Distributions	(43,302)
Endowment Net Assets at June 30, 2016	934,234
Contributions	4,474
Investment gains	112,423
Distributions	(43,046)
Endowment Net Assets at June 30, 2017	$ 1,008,085

Note 15 - Commitments and Contingencies:

Operating Leases

The Arc owns a 49% undivided interest in the North Shores facility land. The remaining 51% is owned by the City of San Diego (the "City"). No rent is payable to the City by The Arc for use of this land unless The Arc is in default of certain terms of the agreement with the City, at which time a specified lease payment amount becomes payable to the City.

The Arc leases property from the County of San Diego for its East County facility under a long-term lease agreement. Under the terms of the agreement, no rent is payable to the County of San Diego as long as The Arc provides certain maintenance services to the surrounding lease area as described in the lease agreement.

In June 2015, The Arc entered into a one-year lease agreement to lease each of the four Crown Point properties at $3,500 per month through June 2016. Rent expense, including property taxes and utilities per lease agreement, under these leases totaled $196,335 for the year ended June 30, 2016. Lease expired June 26, 2016 and was not renewed.

Note 15 - Commitments and Contingencies: (Continued)

Workers' Compensation Coverage

The Arc is self-insured for workers' compensation coverage. The Arc accrues workers' compensation expense based on a combination of actual losses and actuarially-justified loss rates. The Arc's workers' compensation claims administrator provides annually updated accrual rates based upon a rolling five-year historical loss experience analysis. Both the Workers' Compensation Insurance Rating Bureau of California and The Arc's specific loss trends are used to develop the projection. All claims are processed through The Arc's third-party administrator. The Arc maintains a deposit with the third-party administrator, which totaled $133,228 and $60,138 at June 30, 2017 and 2016, respectively. In addition, The Arc maintains stop-loss insurance with Safety National Insurance Group. The policy has a $500,000 per-incident deductible. The State of California Department of Industrial Relations requires The Arc to maintain a security deposit (Note 11). In order to meet this commitment, The Arc has collateralized cash and investments to secure a letter of credit totaling $1,132,879 and $2,507,000 at June 30, 2017 and 2016, respectively. The accrued workers' compensation liability totaled $3,485,115 and $2,636,349 at June 30 2017 and 2016, respectively, and is included in accrued expenses in the accompanying consolidated statements of financial position.

State of California and Medi-Cal Agreements

Under the terms of service agreements with the state of California and Medi-Cal, The Arc submits monthly billings for reimbursement, which are subject to audit. The billings are based on the participant's enrollment and activities according to the agencies' funding policies. Such audits could result in claims against the resources of The Arc. No provision has been made for any liabilities that may arise from such audits since the amount, if any, cannot be determined.

Legal Matters

The Arc is subject to claims that arise out of the normal course of business. The Arc maintains insurance coverage and uses various risk management activities which, combined, management believes are sufficient to ensure that the final outcome of any claims or proceedings will not have an adverse material effect on the consolidated financial position, operations, or liquidity of The Arc.

Note 16 - Retirement Plans:

The Arc has a 401(k) retirement plan (the "401(k) Plan") covering all full time employees of The Arc who have three months of service and are age 21 or older. The 401(k) Plan allows for employee contributions to the plan from 1% to 100% of pretax annual compensation, up to the limit allowed by law, as defined in the 401(k) Plan. The Arc is not required to and did not make any contributions to the 401(k) Plan for the years ended June 30, 2017 and 2016.

Note 16 - Retirement Plans: (Continued)

The Arc has a 403(b) retirement plan (the "403(b) Plan") covering employees who are not eligible for another qualified plan offered by The Arc. The 403(b) Plan year is January 1 through December 31. The minimum age requirement is 21 years, and the minimum service requirement is three months of eligible service. The employer-matching contribution for each plan year was equal to the lesser of (a) 50% of the employee salary reduction contribution, or (b) 2.5% of the employee compensation received during the plan year until July 1, 2013 when the match was suspended. Participants vest in the employer-match portion over a four-year period. The Arc did not make any contributions to the 403(b) Plan for the years ended June 30, 2017 and 2016.

Note 17 - Related-Party Transactions:

During the years ended June 30, 2017 and 2016, The Arc used the services of Alliant Insurance Services ("Alliant") as a third-party claims administrator for The Arc's workers' compensation self-insurance reserve (Note 15). Three members of the Arc of San Diego Foundation's Board of Directors are employees of Alliant. Total premiums of approximately $1,158,977 and $822,000 were paid to Alliant for the years ended June 30, 2017 and 2016, respectively.