

RONALD MCDONALD HOUSE CHARITIES
OF SOUTHERN ARIZONA, INC.

Audited Financial Statements

For the years ended December 31, 2016 and 2015

RONALD MCDONALD HOUSE CHARITIES
OF SOUTHERN ARIZONA, INC.

Table of Contents

| | <u>Page</u> |
|-----------------------------------|-------------|
| Independent Auditor's Report | 1 |
| Financial Statements: | |
| Statements of Financial Position | 2 |
| Statements of Activities | 3 - 4 |
| Statements of Functional Expenses | 5 - 6 |
| Statements of Cash Flows | 7 |
| Notes to Financial Statements | 8 - 16 |



LUDWIG KLEWER & CO. PLLC

Certified Public Accountants & Consultants

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Ronald McDonald House Charities of Southern Arizona, Inc.

We have audited the accompanying financial statements of Ronald McDonald House Charities of Southern Arizona, Inc. (a nonprofit organization), which comprise the statements of financial position as of December 31, 2016 and 2015, and the related statements of activities, functional expenses and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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 financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the 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 financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Ronald McDonald House Charities of Southern Arizona, Inc. as of December 31, 2016 and 2015, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

LUDWIG KLEWER & CO. PLLC

April 17, 2017

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RONALD MCDONALD HOUSE CHARITIES
OF SOUTHERN ARIZONA, INC.

STATEMENTS OF FINANCIAL POSITION
December 31, 2016 and 2015

ASSETS

| | 2016 | 2015 |
|-----------------------------------|---------------|--------------|
| Current assets: | | |
| Cash and cash equivalents | \$ 1,074,471 | \$ 1,228,722 |
| Accounts receivable | 46,748 | 32,370 |
| Bequest receivable | 500,000 | - |
| Investments - current portion | 3,682,100 | 3,181,895 |
| Prepaid expenses | 6,649 | 9,986 |
| Total current assets | 5,309,968 | 4,452,973 |
| Investments - non-current portion | 506,250 | 506,250 |
| Property and equipment, net | 3,840,234 | 3,971,467 |
| Land lease | 671,088 | 687,456 |
| Total assets | \$ 10,327,540 | \$ 9,618,146 |

LIABILITIES AND NET ASSETS

| | | |
|--|---------------|--------------|
| Current liabilities: | | |
| Accounts payable | \$ 20,427 | \$ 22,260 |
| Accrued expenses | 33,045 | 23,310 |
| Deferred grant obligation, current portion | 65,000 | 65,000 |
| Total current liabilities | 118,472 | 110,570 |
| Deferred grant obligation, non-current portion | - | 65,000 |
| Total liabilities | 118,472 | 175,570 |
| Net assets: | | |
| Unrestricted | 8,992,295 | 8,235,481 |
| Temporarily restricted | 710,523 | 700,845 |
| Permanently restricted | 506,250 | 506,250 |
| Total net assets | 10,209,068 | 9,442,576 |
| Total liabilities and net assets | \$ 10,327,540 | \$ 9,618,146 |

See independent auditor's report and accompanying notes.

RONALD MCDONALD HOUSE CHARITIES
OF SOUTHERN ARIZONA, INC.

STATEMENT OF ACTIVITIES
For the year ended December 31, 2016

| | <u>Unrestricted</u> | <u>Temporarily Restricted</u> | <u>Permanently Restricted</u> | <u>Total</u> |
|---------------------------------------|---------------------|-----------------------------------|-----------------------------------|----------------------|
| Revenue and support: | | | | |
| Public support: | | | | |
| Bequests and legacies | \$ 750,143 | \$ - | \$ - | \$ 750,143 |
| Contributions | 673,921 | 49,633 | - | 723,554 |
| Special events | 317,198 | - | - | 317,198 |
| Program service fees | 125,705 | - | - | 125,705 |
| In-kind contributions | 60,299 | - | - | 60,299 |
| Grants | 30,500 | - | - | 30,500 |
| Other support | 5,669 | - | - | 5,669 |
| Total public support | <u>1,963,435</u> | <u>49,633</u> | <u>-</u> | <u>2,013,068</u> |
| Other revenue: | | | | |
| Investment income, net | 164,088 | - | - | 164,088 |
| Total other revenue | <u>164,088</u> | <u>-</u> | <u>-</u> | <u>164,088</u> |
| Total revenue and support | <u>2,127,523</u> | <u>49,633</u> | <u>-</u> | <u>2,177,156</u> |
| Net assets released from restrictions | <u>39,955</u> | <u>(39,955)</u> | <u>-</u> | <u>-</u> |
| Total revenue and support | <u>2,167,478</u> | <u>9,678</u> | <u>-</u> | <u>2,177,156</u> |
| Expenses: | | | | |
| Program services | 1,056,226 | - | - | 1,056,226 |
| General and administrative | 128,026 | - | - | 128,026 |
| Fund-raising | 210,078 | - | - | 210,078 |
| Remittances to RMHC, Inc. | 16,334 | - | - | 16,334 |
| Total expenses | <u>1,410,664</u> | <u>-</u> | <u>-</u> | <u>1,410,664</u> |
| Change in net assets | 756,814 | 9,678 | - | 766,492 |
| Net assets, beginning of year | <u>8,235,481</u> | <u>700,845</u> | <u>506,250</u> | <u>9,442,576</u> |
| Net assets, end of year | <u>\$ 8,992,295</u> | <u>\$ 710,523</u> | <u>\$ 506,250</u> | <u>\$ 10,209,068</u> |

See independent auditor's report and accompanying notes.

RONALD MCDONALD HOUSE CHARITIES
OF SOUTHERN ARIZONA, INC.

STATEMENT OF ACTIVITIES
For the year ended December 31, 2015

| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
|---------------------------------------|--------------|---------------------------|---------------------------|--------------|
| Revenue and support: | | | | |
| Public support: | | | | |
| Contributions | \$ 608,452 | \$ 42,110 | \$ - | \$ 650,562 |
| Special events | 338,722 | - | - | 338,722 |
| Grants | 30,000 | - | - | 30,000 |
| In-kind contributions | 28,242 | - | - | 28,242 |
| Bequests and legacies | 12,256 | - | - | 12,256 |
| Other support | 4,920 | - | - | 4,920 |
| Total public support | 1,022,592 | 42,110 | - | 1,064,702 |
| Other revenue: | | | | |
| Investment loss, net | (92,388) | - | - | (92,388) |
| Total other revenue | (92,388) | - | - | (92,388) |
| Total revenue and support | 930,204 | 42,110 | - | 972,314 |
| Net assets released from restrictions | 58,011 | (58,011) | - | - |
| Total revenue and support | 988,215 | (15,901) | - | 972,314 |
| Expenses: | | | | |
| Program services | 949,929 | - | - | 949,929 |
| General and administrative | 107,796 | - | - | 107,796 |
| Fund-raising | 191,436 | - | - | 191,436 |
| Remittances to RMHC, Inc. | 14,875 | - | - | 14,875 |
| Total expenses | 1,264,036 | - | - | 1,264,036 |
| Change in net assets | (275,821) | (15,901) | - | (291,722) |
| Net assets, beginning of year | 8,511,302 | 716,746 | 506,250 | 9,734,298 |
| Net assets, end of year | \$ 8,235,481 | \$ 700,845 | \$ 506,250 | \$ 9,442,576 |

See independent auditor's report and accompanying notes.

RONALD MCDONALD HOUSE CHARITIES
OF SOUTHERN ARIZONA, INC.

STATEMENT OF FUNCTIONAL EXPENSES
For the year ended December 31, 2016

| | Program | General and Administrative | Fund-raising | Total |
|---|---------------------|----------------------------------|-------------------|---------------------|
| Payroll | \$ 447,351 | \$ 53,636 | \$ 49,993 | \$ 550,980 |
| Benefits | 43,183 | 5,621 | 5,150 | 53,954 |
| Payroll taxes | 33,890 | 4,027 | 3,766 | 41,683 |
| Total payroll and related expenses | 524,424 | 63,284 | 58,909 | 646,617 |
| Depreciation | 137,098 | 27,419 | 6,855 | 171,372 |
| Promotions | 74,987 | - | 91,928 | 166,915 |
| Special event direct donor benefit costs | 71,780 | - | - | 71,780 |
| Utilities | 41,171 | 8,235 | 2,058 | 51,464 |
| Professional services | 31,422 | 8,152 | 6,623 | 46,197 |
| Repairs and maintenance | 33,564 | 1,747 | 546 | 35,857 |
| House expense | 35,642 | - | - | 35,642 |
| Insurance | 20,798 | 2,543 | 1,415 | 24,756 |
| Household supplies | 24,745 | - | - | 24,745 |
| Telephone | 18,967 | 2,186 | 772 | 21,925 |
| Printing and publication | 6,158 | 991 | 11,289 | 18,438 |
| Donor and volunteer recognition | 7,860 | 3,856 | 6,629 | 18,345 |
| Rent - land lease | 13,094 | 2,619 | 655 | 16,368 |
| Miscellaneous expense | 1,438 | 421 | 9,008 | 10,867 |
| Travel and transportation | 4,190 | 1,176 | 3,048 | 8,414 |
| Conferences and meetings | 1,697 | 2,907 | 3,542 | 8,146 |
| Office supplies | 3,686 | 1,713 | 1,416 | 6,815 |
| Postage | 1,339 | 400 | 3,546 | 5,285 |
| Dues and subscriptions | 2,166 | 377 | 1,839 | 4,382 |
| Total functional expenses | <u>\$ 1,056,226</u> | <u>\$ 128,026</u> | <u>\$ 210,078</u> | <u>\$ 1,394,330</u> |

See independent auditor's report and accompanying notes.

RONALD MCDONALD HOUSE CHARITIES
OF SOUTHERN ARIZONA, INC.

STATEMENT OF FUNCTIONAL EXPENSES
For the year ended December 31, 2015

| | Program | General and Administrative | Fund-raising | Total |
|---|------------|----------------------------------|--------------|--------------|
| Payroll | \$ 379,053 | \$ 45,227 | \$ 44,527 | \$ 468,807 |
| Benefits | 33,373 | 4,850 | 4,136 | 42,359 |
| Payroll taxes | 28,925 | 3,433 | 3,378 | 35,736 |
| Total payroll and related expenses | 441,351 | 53,510 | 52,041 | 546,902 |
| Promotions | 77,509 | - | 98,485 | 175,994 |
| Depreciation | 132,105 | 26,421 | 6,605 | 165,131 |
| Special event direct donor benefit costs | 69,720 | - | - | 69,720 |
| Repairs and maintenance | 48,173 | 1,424 | 399 | 49,996 |
| Utilities | 38,524 | 7,705 | 1,926 | 48,155 |
| House expense | 31,582 | - | - | 31,582 |
| Professional services | 20,364 | 5,004 | 4,241 | 29,609 |
| Telephone | 17,057 | 2,043 | 774 | 19,874 |
| Insurance | 14,695 | 2,317 | 1,135 | 18,147 |
| Household supplies | 17,335 | - | - | 17,335 |
| Rent - land lease | 13,094 | 2,619 | 655 | 16,368 |
| Printing and publication | 4,180 | 501 | 10,562 | 15,243 |
| Travel and transportation | 6,418 | 1,796 | 1,791 | 10,005 |
| Conferences and meetings | 2,272 | 2,246 | 3,207 | 7,725 |
| Donor and volunteer recognition | 6,069 | 863 | 136 | 7,068 |
| Office supplies | 5,171 | 452 | 492 | 6,115 |
| Postage | 2,138 | 483 | 2,527 | 5,148 |
| Miscellaneous expense | 131 | 272 | 4,671 | 5,074 |
| Dues and subscriptions | 2,041 | 140 | 1,789 | 3,970 |
| Total functional expenses | \$ 949,929 | \$ 107,796 | \$ 191,436 | \$ 1,249,161 |

See independent auditor's report and accompanying notes.

RONALD MCDONALD HOUSE CHARITIES
OF SOUTHERN ARIZONA, INC.

STATEMENTS OF CASH FLOWS
For the years ended December 31, 2016 and 2015

| | 2016 | 2015 |
|---|--------------|--------------|
| Cash flows from operating activities: | | |
| Change in net assets | \$ 766,492 | \$ (291,722) |
| Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities: | | |
| Donated securities | (27,575) | (25,058) |
| Net realized and unrealized (gain) loss on investments | (104,345) | 174,672 |
| Depreciation | 171,372 | 165,131 |
| Donated equipment | (25,000) | (918) |
| Amortization of land lease | 16,368 | 16,368 |
| Scheduled release of deferred grant obligation | (65,000) | (65,000) |
| Change in operating assets and liabilities: | | |
| Accounts receivable | (14,378) | 1,529 |
| Bequests and legacies | (500,000) | - |
| Prepaid expenses | 3,337 | 3,494 |
| Accounts payable | (1,833) | 8,477 |
| Accrued expenses | 9,735 | (4,482) |
| Total adjustments | (537,319) | 274,213 |
| Net cash provided by (used in) operating activities | 229,173 | (17,509) |
| Cash flows from investing activities: | | |
| Purchases of property and equipment | (15,139) | (57,840) |
| Purchases of investments | (3,248,776) | (3,803,582) |
| Proceeds from sale of investments | 2,880,491 | 3,628,248 |
| Net cash used in investing activities | (383,424) | (233,174) |
| Cash flows from financing activities | - | - |
| Net change in cash and cash equivalents | (154,251) | (250,683) |
| Cash and cash equivalents, beginning of year | 1,228,722 | 1,479,405 |
| Cash and cash equivalents, end of year | \$ 1,074,471 | \$ 1,228,722 |
| Schedule of cash flow information: | | |
| Cash paid for taxes | \$ - | \$ - |
| Schedule of noncash investing and financing activities: | | |
| Donated equipment | \$ 25,000 | \$ 918 |
| Donated securities | \$ 27,575 | \$ 25,058 |

See independent auditor's report and accompanying notes.

RONALD MCDONALD HOUSE CHARITIES
OF SOUTHERN ARIZONA, INC.

NOTES TO FINANCIAL STATEMENTS
For the years ended December 31, 2016 and 2015

1. Nature of Activities

Ronald McDonald House Charities of Southern Arizona, Inc. (RMHCSA) is a nonprofit corporation organized under the laws of the State of Arizona. The mission of RMHCSA is to create, find and support programs that directly improve the health and well-being of children and their families. In Southern Arizona, our primary services are to provide a home-away-from-home for families with critically ill children; a Ronald McDonald Family Room at Banner Children's Diamond Children's Medical Center, to give families of pediatric patients a place to rest and regroup; and Caring Carts at both Diamond Children's and Tucson Medical Center, to share snacks, toys for kids and goodwill throughout the neonatal intensive care and pediatric units. RMHCSA's primary funding comes from public contributions.

2. Summary of Significant Accounting Policies

Financial Statement Presentation

The financial statements are prepared using the accrual method of accounting in accordance with accounting principles generally accepted in the United States of America. The information regarding its financial position and activities are presented according to three classes of net assets (unrestricted, temporarily restricted and permanently restricted) based upon the existence or absence of donor-imposed restrictions.

- 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 may or will be met either by actions of RMHCSA and/or the passage of time. When a restriction expires, 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 that they be maintained permanently by RMHCSA. Generally, the donors of these assets permit RMHCSA to use all or part of the income earned on any related investments for general or specific purposes.

All contributions are considered to be available for unrestricted use unless specifically restricted by the donor. Amounts received that are designated for future periods or restricted by the donor for specific purposes are reported as temporarily restricted or permanently restricted support that increase those net asset classes. When a temporary restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions.

Accounting 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 these estimates.

Cash and Cash Equivalents

It is RMHCSA's policy to invest excess cash in income-producing investments. Cash and cash equivalents consist of certificates of deposit with financial institutions and money market accounts. RMHCSA considers highly liquid investments, including certificates of deposit, purchased with original maturities of ninety days or less to be cash equivalents.

See independent auditor's report.

RONALD MCDONALD HOUSE CHARITIES
OF SOUTHERN ARIZONA, INC.

NOTES TO FINANCIAL STATEMENTS
For the years ended December 31, 2016 and 2015

2. Summary of Significant Accounting Policies, Continued

Accounts Receivable

Accounts receivable totaled \$46,748 and \$32,370 at December 31, 2016 and 2015, respectively. Management believes all amounts are fully collectible, therefore no allowance for doubtful accounts has been recorded. There are no receivables that are considered delinquent at December 31, 2016 and 2015.

Bequests Receivable

Support arising from bequests and legacies is recognized by RMHCSA when it has been established that there are no uncertainties as to the beneficiaries and the amounts can be reasonably estimated. The net balance of these bequests receivable is \$500,000 and \$-0- at December 31, 2016 and 2015, respectively.

Investments

In accordance with accounting principles generally accepted in the United States of America applicable to nonprofit organizations, investments in marketable securities with readily determinable fair values and all investments in debt securities are valued at their fair values in the statement of financial position. Unrealized gains and losses are included in the change in net assets.

Property and Equipment

Purchased property and equipment is recorded at cost. Donations of property and equipment are recorded as support at their estimated fair value. Such donations are reported as unrestricted support unless the donor has restricted the donated assets 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, RMHCSA reports expirations of donor restrictions when the donated or acquired assets are placed in service as instructed by the donor. RMHCSA reclassifies temporarily restricted net assets to unrestricted net assets at that time.

The cost of maintenance and repairs is charged to expense in the year incurred. Expenditures greater than \$1,000 that increase the useful lives of the assets are capitalized and depreciated. Property and equipment is depreciated using the straight-line method over the following estimated useful lives of the assets:

| | |
|-------------------------------------|-------------|
| Buildings and building improvements | 10-40 years |
| Equipment | 3-7 years |
| Furniture and fixtures | 5-7 years |
| Vehicles | 5 years |

Donated Services, Materials and Facilities

Donated materials and facilities are valued at their fair market value. Donated services are recognized in the financial statements at their fair market value if the following criteria are met:

- The services require specialized skills and are provided by individuals possessing those skills; and
- The services would typically need to be purchased if not donated.

See independent auditor's report.

RONALD MCDONALD HOUSE CHARITIES
OF SOUTHERN ARIZONA, INC.

NOTES TO FINANCIAL STATEMENTS
For the years ended December 31, 2016 and 2015

2. Summary of Significant Accounting Policies, Continued

Donated Services, Materials and Facilities, continued

Although RMHCSA utilizes the services of many outside volunteers, the fair value of these services is not recognized in the accompanying financial statements since they do not meet the criteria for recognition under accounting principles generally accepted in the United States of America. RMHCSA recorded contributed services and materials support and related expenses of \$60,299 and \$28,242, of which \$44,178 and \$21,403 was used in support of RMHCSA programs during the years ended December 31, 2016 and 2015, respectively. Of the related expenses noted above, \$25,000 and \$918, respectively, were capitalized as property and equipment during the years ended December 31, 2016 and 2015.

Functional Allocation of Expenses

The costs of providing program and supporting services have been summarized on a functional basis in the accompanying financial statements. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

Advertising Costs

The cost of advertising is expensed when incurred or when the first advertising takes place. RMHCSA does not participate in direct-response advertising, which requires the capitalization and amortization of the related cost.

Income Taxes

RMHCSA is exempt from federal income tax under Internal Revenue Code Section (IRC) 501(c)(3) and from Arizona income tax under Arizona Revised Statute Section 43-1201(4). RMHCSA is classified as other than a private foundation under Section 509(a)(1) of the IRC.

RMHCSA's policy is to disclose or recognize income tax positions based on management's estimate of whether it is reasonably possible or probable, respectively, that a liability has been incurred for unrecognized income tax positions. As of December 31, 2016, there were no uncertain tax positions that are potentially material. In addition, management is not aware of any matters which would cause RMHCSA to lose its tax-exempt status.

Reclassifications

Certain items from the 2015 financial statements have been reclassified to conform to the 2016 financial statement presentation.

3. Concentration of Risk

Cash balances are maintained at various financial institutions. The Federal Deposit Insurance Corporation (FDIC) insures cash accounts at banks up to \$250,000 per institution. The National Credit Union Administration (NCUA) insures all cash accounts at credit unions up to \$250,000 per institution. Investments held by other institutions are covered up to \$500,000 under insurance provided by the Securities Investor Protection Corporation (SIPC). However, SIPC does not protect against losses in market value. At December 31, 2016 and 2015, RMHCSA has \$3,996,500 and \$3,829,714, respectively, in a financial institution in excess of the federally insured limits. It is the opinion of management that the solvency of the referenced financial institutions is not of concern at this time.

See independent auditor's report.

RONALD MCDONALD HOUSE CHARITIES
OF SOUTHERN ARIZONA, INC.

NOTES TO FINANCIAL STATEMENTS
For the years ended December 31, 2016 and 2015

4. Investments

Investments are valued at fair market value and consist of the following at December 31,:

| | 2016 | 2015 |
|----------------------------|--------------|--------------|
| Fixed income funds | \$ 1,930,482 | \$ 1,736,593 |
| Stocks | 1,504,409 | 1,245,438 |
| International stocks | 540,352 | 481,890 |
| Interest in business trust | 177,975 | 199,934 |
| Other assets | 35,132 | 24,290 |
| Total investments | 4,188,350 | 3,688,145 |
| Less current portion | (3,682,100) | (3,181,895) |
| Non-current portion | \$ 506,250 | \$ 506,250 |

Investment income (loss) consists of the following for the years ended December 31,:

| | 2016 | 2015 |
|---|------------|-------------|
| Interest and dividend income | \$ 103,586 | \$ 115,778 |
| Net realized and unrealized gain (loss) | 104,345 | (174,672) |
| Investment expense | (43,843) | (33,494) |
| Investment income (loss), net | \$ 164,088 | \$ (92,388) |

5. Fair Value Measurements

The Financial Accounting Standards Board has established a framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy are described as follows:

Level 1: Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that RMHCSA has the ability to access.

Level 2: Inputs to the valuation methodology include:

- Quoted prices for similar assets or liabilities in active markets;
- Quoted prices for identical or similar assets or liabilities in inactive markets;
- Inputs other than quoted prices that are observable for the asset or liability;
- Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.

See independent auditor's report.

RONALD MCDONALD HOUSE CHARITIES
OF SOUTHERN ARIZONA, INC.

NOTES TO FINANCIAL STATEMENTS
For the years ended December 31, 2016 and 2015

5. Fair Value Measurements, Continued

Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at December 31, 2016 and 2015.

- *Stocks, fixed income funds, mutual funds, other assets:* Valued at fair value based on national trade listing.
- *Interest in business trust:* Valued at the fair value of the underlying investments as reported by third parties.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while RMHCSA believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

Fair values of assets measured on a recurring basis at December 31, 2016 are:

| | Level 1 | Level 2 | Level 3 | Total |
|----------------------------|---------------------|-------------------|-------------|---------------------|
| Fixed income funds | \$ 1,930,482 | \$ - | \$ - | \$ 1,930,482 |
| Stocks | 1,504,409 | - | - | 1,504,409 |
| International stocks | 540,352 | - | - | 540,352 |
| Interest in business trust | - | 177,975 | - | 177,975 |
| Other assets | 35,132 | - | - | 35,132 |
| Total | <u>\$ 4,010,375</u> | <u>\$ 177,975</u> | <u>\$ -</u> | <u>\$ 4,188,350</u> |

Fair values of assets measured on a recurring basis at December 31, 2015 are:

| | Level 1 | Level 2 | Level 3 | Total |
|----------------------------|---------------------|-------------------|-------------|---------------------|
| Fixed income funds | \$ 1,736,593 | \$ - | \$ - | \$ 1,736,593 |
| Stocks | 1,245,438 | - | - | 1,245,438 |
| International stocks | 481,890 | - | - | 481,890 |
| Interest in business trust | - | 199,934 | - | 199,934 |
| Other assets | 24,290 | - | - | 24,290 |
| Total | <u>\$ 3,488,211</u> | <u>\$ 199,934</u> | <u>\$ -</u> | <u>\$ 3,688,145</u> |

See independent auditor's report.

RONALD MCDONALD HOUSE CHARITIES
OF SOUTHERN ARIZONA, INC.

NOTES TO FINANCIAL STATEMENTS
For the years ended December 31, 2016 and 2015

6. Property and Equipment

Property and equipment consists of the following at December 31,:

| | 2016 | 2015 |
|-------------------------------------|--------------|--------------|
| Buildings and building improvements | \$ 5,037,141 | \$ 4,999,580 |
| Equipment | 158,316 | 155,583 |
| Furniture and fixtures | 239,624 | 239,624 |
| Vehicles | 52,959 | 52,959 |
| Total property and equipment | 5,488,040 | 5,447,746 |
| Less accumulated depreciation | (1,647,806) | (1,476,279) |
| Property and equipment, net | \$ 3,840,234 | \$ 3,971,467 |

7. Land Lease

RMHCSA is leasing the land upon which the current facility has been built. The lease term is 50 years at an annual rental of \$1. The fair market value of the land at inception was approximately \$818,400. Annual amortization of the lease value is \$16,368. The contribution has been recorded as temporarily restricted support to reflect the use restriction of the land to the operation of the Ronald McDonald House for the 50-year lease term. RMHCSA will release \$16,368 to unrestricted net assets annually over the 50-year lease term. As of December 31, 2016 and 2015, the value of the land lease, net of accumulated amortization, is \$671,088 and \$687,456, respectively.

8. Deferred Grant Obligation

During the year ended December 31, 2005, Angel Charity made a \$550,000 pledge to RMHCSA in support of a capital campaign. The pledge was increased to \$650,000 during the year ended December 31, 2006. On November 27, 2007, RMHCSA executed a non-recourse, non interest-bearing promissory note in favor of Angel Charity in the amount of \$650,000. The note provides that, on the condition RMHCSA continues to utilize the facility to provide the Ronald McDonald House Services, Angel Charity will forgive the note at a rate of \$65,000 per year for a ten-year period beginning with the year ended November 27, 2008 so that by the maturity date of November 27, 2017, the entire \$650,000 shall have been forgiven by Angel Charity. At December 31, 2016 and 2015, the balance of the deferred grant obligation is \$65,000 and \$130,000, respectively.

See independent auditor's report.

RONALD MCDONALD HOUSE CHARITIES
OF SOUTHERN ARIZONA, INC.

NOTES TO FINANCIAL STATEMENTS
For the years ended December 31, 2016 and 2015

9. Net Assets

Net assets consist of the following at December 31,:

| | 2016 | 2015 |
|---|---------------|--------------|
| Unrestricted net assets: | | |
| Undesignated and available for operations | \$ 4,196,758 | \$ 3,339,731 |
| Investment in property and equipment, net | 3,775,234 | 3,841,467 |
| Board designated: | | |
| Reserve for operations | 500,000 | 500,000 |
| Property replacement | 484,076 | 499,003 |
| Program expansion | 26,313 | 28,013 |
| Marketing plan | 9,914 | 27,267 |
| Total unrestricted net assets | 8,992,295 | 8,235,481 |
| Temporarily restricted net assets: | | |
| Land lease | 671,088 | 687,456 |
| Global grant fund | 22,500 | 3,190 |
| Family room | 7,390 | 9,330 |
| Other donor restricted | 5,485 | 869 |
| Family fund | 4,060 | - |
| Total temporarily restricted net assets | 710,523 | 700,845 |
| Permanently restricted net assets | 506,250 | 506,250 |
| Total net assets | \$ 10,209,068 | \$ 9,442,576 |

10. Endowment Funds

RMHCSA's endowment includes donor restricted funds. As required by accounting principles generally accepted in the United States of America, net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

The Board of Directors of RMHCSA has interpreted Arizona's version (Titled the "Management of Charitable Funds Act" (the Act)) of the Uniform Prudent Management of Institutional Funds Act (UPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, RMHCSA classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by RMHCSA in a manner consistent with the standard of prudence prescribed by the Act.

See independent auditor's report.

RONALD MCDONALD HOUSE CHARITIES
OF SOUTHERN ARIZONA, INC.

NOTES TO FINANCIAL STATEMENTS
For the years ended December 31, 2016 and 2015

10. Endowment Funds, Continued

RMHCSA has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by the endowment fund while seeking to maintain the original value of any contributions to the endowment assets. Endowment assets include those assets of donor-restricted funds that RMHCSA must hold in perpetuity. Under this policy, as approved by the board of directors, the endowment assets are invested with a growth and income style of investing in a portfolio comprised of cash, fixed income securities, equities and mutual funds. Investment income is appropriated for expenditure in the year earned, and is, therefore, included in unrestricted net assets.

Endowment net asset composition as of December 31, 2016 and 2015 consists of:

| | Unrestricted | Temporarily Restricted | Permanently Restricted |
|----------------------------------|--------------|---------------------------|---------------------------|
| Donor-designated endowment funds | \$ - | \$ - | \$ 506,250 |

There were no changes in endowment net assets during the years ended December 31, 2016 and 2015.

11. Special Events

Special event activities for the year ended December 31, 2016 are:

| | Revenue | Direct Donor Benefit Costs | Indirect Expenses | Net |
|-----------------------------|------------|-------------------------------|----------------------|------------|
| Ronald McDonald House Party | \$ 209,037 | \$ 48,533 | \$ 8,259 | \$ 152,245 |
| Walk for Kids | 108,161 | 23,247 | 4,043 | 80,871 |
| | \$ 317,198 | \$ 71,780 | \$ 12,302 | \$ 233,116 |

Special event activities for the year ended December 31, 2015 are:

| | Revenue | Direct Donor Benefit Costs | Indirect Expenses | Net |
|-----------------------------|------------|-------------------------------|----------------------|------------|
| Ronald McDonald House Party | \$ 211,711 | \$ 48,914 | \$ 8,256 | \$ 154,541 |
| Walk for Kids | 127,011 | 20,806 | 4,690 | 101,515 |
| | \$ 338,722 | \$ 69,720 | \$ 12,946 | \$ 256,056 |

Special event expenses reported above for each of the years ended December 31, 2016 and 2015 include direct donor benefit costs allocated to program activities and other indirect expenses allocated to fundraising activities as reported on the Statements of Functional Expenses.

See independent auditor's report.

RONALD MCDONALD HOUSE CHARITIES
OF SOUTHERN ARIZONA, INC.

NOTES TO FINANCIAL STATEMENTS
For the years ended December 31, 2016 and 2015

12. Lease Commitments

RMHCSA leases office equipment under two operating leases maturing in March 2017 and May 2019. Lease expenses for the office equipment during each of the years ended December 31, 2016 and 2015 was \$4,317.

Future minimum lease payments through the end of the lease terms are:

| Year ended <u>December 31,</u> | |
|-----------------------------------|-----------------|
| 2017 | \$ 3,516 |
| 2018 | 3,249 |
| 2019 | <u>1,354</u> |
| | <u>\$ 8,119</u> |

13. Joint Cost Allocations

During the year ended December 31, 2016, RMHCSA incurred joint costs of \$60,697 for informational materials that included fund-raising appeals. RMHCSA allocated \$15,175 to program expense and \$45,522 to fund-raising expenses.

During the year ended December 31, 2015, RMHCSA incurred joint costs of \$67,572 for informational materials that included fund-raising appeals. RMHCSA allocated \$16,893 to program expense and \$50,679 to fund-raising expenses.

14. Simplified Employee Pension Plan

RMHCSA contributes to a simplified employee pension plan for its employees who are over the age of 21. The employer agrees to provide for discretionary contributions in each calendar year to the Individual Retirement Accounts for all eligible employees who received at least \$5,000 in compensation for the current calendar year and who received at least \$5,000 in compensation during any one prior year. Contributions to the plan for the years ended December 31, 2016 and 2015 were \$8,522 and \$11,347, respectively.

15. Related Party Transactions

During the years ended December 31, 2016 and 2015, RMHCSA paid \$7,948 and \$2,132, respectively, to Nextrio for IT services and equipment. Nextrio also provided in-kind computer consulting services totaling \$12,275 and \$8,507 for the years ended December 31, 2016 and 2015, respectively. A founder of Nextrio is also a board member of RMHCSA.

During the years ended December 31, 2016 and 2015, RMHCSA received \$152,899 and \$175,390, respectively, in support and contributions from the McDonald's of Southern Arizona Operator's Association (Association). The Association is comprised of McDonald's operators in Southern Arizona, and three of those operators are members of the RMHCSA Board of Directors.

16. Subsequent Events

RMHCSA was unaware of any subsequent events as of April 17, 2017, the date the financial statements were available to be issued.

See independent auditor's report.

