

**METHODIST CHILDREN'S HOME
FINANCIAL STATEMENTS
FOR THE YEARS ENDED
JUNE 30, 2017 AND 2016**

WITH INDEPENDENT AUDITORS' REPORT

METHODIST CHILDREN'S HOME

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Methodist Children's Home

Report on the Financial Statements

We have audited the accompanying statements of financial position of Methodist Children's Home (a nonprofit organization) as of June 30, 2017 and 2016, and the related statements of activities, 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.

Auditors' 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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider 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 Methodist Children's Home 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.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued a separate report dated November 7, 2017, on our consideration of the Methodist Children's Home's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.



Austin, Texas

November 7, 2017

METHODIST CHILDREN'S HOME
STATEMENTS OF FINANCIAL POSITION
JUNE 30, 2017 AND 2016

	2017	2016
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 7,052,577	\$ 2,588,178
Receivables	132,603	119,264
Pledges, net	409,406	294,785
Supplies and prepaid expenses	73,583	79,724
Total Current Assets	7,668,169	3,081,951
PROPERTY & EQUIPMENT, NET OF DEPRECIATION	10,666,481	9,424,650
LONG-TERM PLEDGES, NET	26,733	161,004
ENDOWMENT		
Invested cash	46,811,068	10,216,924
Corporate stock	307,095,183	310,803,385
Fixed income securities	65,260,619	71,641,918
Third party trusts	20,134,480	18,397,440
Mineral rights	17,167,581	19,993,179
Real estate	2,196,043	2,196,473
Mortgage loans and others	177,941	196,848
Total Endowment	458,842,915	433,446,167
TOTAL ASSETS	\$ 477,204,298	\$ 446,113,772

The accompanying notes to financial statements are an integral part of these statements.

METHODIST CHILDREN'S HOME
STATEMENTS OF FINANCIAL POSITION
JUNE 30, 2017 AND 2016

	2017	2016
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Accounts payable	\$ 511,976	\$ 656,764
Accrued salaries	1,792,574	1,994,889
Current portion of gift annuities payable	138,361	122,615
Total Current Liabilities	2,442,911	2,774,268
 LONG-TERM PORTION OF GIFT ANNUITIES PAYABLE	 665,368	 619,195
Total Liabilities	3,108,279	3,393,463
 NET ASSETS		
Unrestricted		
General operating	(1,032,459)	471,103
Defined income	14,705,254	13,729,826
Board-designated endowment fund	434,365,397	405,172,656
Plant	10,666,481	9,424,650
Total Unrestricted Net Assets	458,704,673	428,798,235
Temporarily restricted	6,011,068	5,771,372
Permanently restricted	9,380,278	8,150,702
Total Net Assets	474,096,019	442,720,309
 TOTAL LIABILITIES AND NET ASSETS	 \$ 477,204,298	 \$ 446,113,772

The accompanying notes to financial statements are an integral part of these statements.

METHODIST CHILDREN'S HOME
STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2017

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
REVENUES				
Operational revenues				
Contributions and donations	\$ 3,294,459	\$ -	\$ -	\$ 3,294,459
Program and grants	1,619,784	-	-	1,619,784
Other income	30,496	-	-	30,496
Total operational revenues	4,944,739	-	-	4,944,739
Appropriated to general fund	20,169,000	-	-	20,169,000
Total revenues	25,113,739	-	-	25,113,739
PROGRAM SERVICES	22,709,066	-	-	22,709,066
SUPPORTING SERVICES	4,519,019	-	-	4,519,019
OTHER INCOME (EXPENSES)				
Gifts and bequests	1,256,738	2,488,113	1,172,891	4,917,742
Income earned on investments	13,749,914	562,332	56,685	14,368,931
Investment expenses	(3,136,797)	-	-	(3,136,797)
Realized gains (losses)				
on investments	18,232,682	-	-	18,232,682
Change in unrealized gains (losses)				
on investments	19,276,498	-	-	19,276,498
Satisfaction of program restrictions	2,810,749	(2,810,749)	-	-
Appropriated to general fund	(20,169,000)	-	-	(20,169,000)
Total other income (expenses)	32,020,784	239,696	1,229,576	33,490,056
CHANGE IN NET ASSETS	29,906,438	239,696	1,229,576	31,375,710
NET ASSETS, BEGINNING	428,798,235	5,771,372	8,150,702	442,720,309
NET ASSETS, END	<u>\$ 458,704,673</u>	<u>\$ 6,011,068</u>	<u>\$ 9,380,278</u>	<u>\$ 474,096,019</u>

The accompanying notes to financial statements are an integral part of these statements.

METHODIST CHILDREN'S HOME
STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2016

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
REVENUES				
Operational revenues				
Contributions and donations	\$ 3,282,354	\$ -	\$ -	\$ 3,282,354
Program and grants	1,392,093	-	-	1,392,093
Other income	54,363	-	-	54,363
Total operational revenues	4,728,810	-	-	4,728,810
Appropriated to general fund	19,174,008	-	-	19,174,008
Total revenues	23,902,818	-	-	23,902,818
PROGRAM SERVICES	22,509,090	-	-	22,509,090
SUPPORTING SERVICES	4,480,517	-	-	4,480,517
OTHER INCOME (EXPENSES)				
Gifts and bequests	2,635,172	2,099,050	1,489,859	6,224,081
Income earned on investments	15,438,773	515,735	52,864	16,007,372
Investment expenses	(2,579,058)	-	-	(2,579,058)
Realized gains (losses)				
on investments	3,048,471	-	-	3,048,471
Change in unrealized gains (losses)				
on investments	(52,614,127)	-	-	(52,614,127)
Satisfaction of program restrictions	823,559	(823,559)	-	-
Appropriated to general fund	(19,174,008)	-	-	(19,174,008)
Total other income (expenses)	(52,421,218)	1,791,226	1,542,723	(49,087,269)
CHANGE IN NET ASSETS	(55,508,007)	1,791,226	1,542,723	(52,174,058)
NET ASSETS, BEGINNING	484,306,242	3,980,146	6,607,979	494,894,367
NET ASSETS, END	\$ 428,798,235	\$ 5,771,372	\$ 8,150,702	\$ 442,720,309

The accompanying notes to financial statements are an integral part of these statements.

**METHODIST CHILDREN'S HOME
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2017 AND 2016**

	<u>2017</u>	<u>2016</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	\$ 31,375,710	\$ (52,174,058)
Adjustments to reconcile change in net assets to net change in cash from operating activities:		
Depreciation and amortization	1,223,152	885,406
Allowance for doubtful pledges	(48,531)	(50,915)
(Gain)/loss on sale of assets	14,225	6,584
Realized losses (gains) on investments	(18,232,682)	(2,598,641)
Unrealized (gains) losses on investments	(19,276,498)	52,614,127
Contributions restricted for endowment	(1,172,891)	(1,489,859)
Decrease (increase) in assets:		
Accounts receivable	(13,339)	12,250
Pledges	68,181	(404,874)
Supplies and prepaid expenses	6,141	80,539
Increase (decrease) in liabilities:		
Accounts payable	(144,788)	351,940
Accrued salaries	(202,315)	440,130
Gift annuities	61,919	(516,968)
Net Change in Cash from Operating Activities	<u>(6,341,716)</u>	<u>(2,844,339)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Net proceeds (purchases) from sale of investments	12,112,432	(643,565)
Proceeds from sales of capital assets	67,633	64,325
Purchase of capital items	(2,546,841)	(2,203,396)
Net Change in Cash from Investing Activities	<u>9,633,224</u>	<u>(2,782,636)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Endowment contributions	1,172,891	1,489,859
Net Change in Cash from Financing Activities	<u>1,172,891</u>	<u>1,489,859</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	4,464,399	(4,137,116)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>2,588,178</u>	<u>6,725,294</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 7,052,577</u>	<u>\$ 2,588,178</u>

The accompanying notes to financial statements are an integral part of these statements.

METHODIST CHILDREN'S HOME
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2017 AND 2016

1. Summary of Significant Accounting Policies

The Methodist Children's Home (MCH) prepares its financial statements in accordance with generally accepted accounting principles in the United States of America. The application of these accounting principles requires MCH to distinguish between contributions that increase permanently restricted net assets, temporarily restricted net assets, and unrestricted net assets. They also require recognition of contributions, including contributed service meeting certain criteria, at fair values. Below is a summary of certain significant accounting policies selected by management.

A. Nature of Organization

The Methodist Children's Home, established in 1890, has focused its mission on caring for at-risk children from Texas and New Mexico. MCH serves children from infancy all the way through after-care services, such as college and transitional living programs. The residential program has a capacity of 358 and MCH provides a variety of in-home services for children and families through its outreach offices.

B. Basis of Presentation

The financial statements of MCH have been prepared on the accrual basis of accounting and, accordingly, reflect all significant receivables, payables and other liabilities in accordance with generally accepted accounting principles.

C. Codification

The Financial Accounting Standards Board's (FASB) Accounting Standards Codification (ASC) is the single official source of authoritative, nongovernmental U. S. generally accepted accounting principles (GAAP).

D. Use of Accounting Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

E. Cash and Cash Equivalents

The indirect method is used to prepare the statement of cash flows. For the purposes of this statement, MCH considers cash in bank accounts and all highly liquid investments with original maturity of three months or less at the date of acquisition to be "cash equivalents" excluding those funds that are assigned to investment managers for long-term investment purposes.

F. Net Asset Categories

U.S. generally accepted accounting principles require that resources be classified into three net asset categories according to donor-imposed restrictions or by law.

METHODIST CHILDREN'S HOME
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2017 AND 2016

1. Summary of Significant Accounting Policies (Continued)

F. Net Asset Categories - Continued

Unrestricted net assets include (1) contributions for which the donor has specifically identified the usage as current operations or no usage was specified, (2) Board designated endowment funds, (3) Board designated endowment earning released for operations, and (4) plant acquisitions.

Temporarily restricted net assets include contributions for which specific donor restrictions have not yet been met. The majority of the balance in this category was derived from accumulated earnings on permanently restricted scholarship funds to be used exclusively for the funding of higher education for MCH's children.

Permanently restricted net assets include contributions permanently restricted by the donor.

G. Investments

Investments in marketable securities, funds administered by third party trustees, and mineral rights are valued at their estimated fair values in the statement of financial position. Unrealized gains and losses are included in the statement of activities. All other investments are carried at cost.

It is MCH's policy that the endowment fund's accounts are to include both equity and fixed income (including cash) assets. MCH has elected to have separate investment advisors and accounts for common stock and fixed income investment management. Each investment advisor is given the authority to be fully invested in their respective asset category. The Investment Policy allows for the following allocation of total endowment: Equities of 40-75%, Fixed Income of 15-30%, and Alternative Assets of 0-35%.

MCH investment policy represents a conservative investment strategy designed to obtain a total return necessary to enhance the principal, while concurrently providing a consistent source of income. Investment managers of equity or fixed income portions of the portfolio are expected to produce rates of return that rank in the top 50 percent of their respective peer groups. Standard and Poor's 500 Index is the benchmark used to evaluate returns. The endowment fund should be diversified to minimize risk of loss, with the equity portion assuming more risk and greater earning potential, while the fixed income portion assumes less risk and generates lower long-term earnings.

H. Fair Value Measurements

FASB ASC 820, *Fair Value Measurements and Disclosures*, establishes 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 under FASB ASC 820 are described as follows:

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

METHODIST CHILDREN'S HOME
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2017 AND 2016

1. Summary of Significant Accounting Policies (Continued)

H. Fair Value Measurements - Continued

- Level 2 - Inputs to the valuation methodology include:
- Quoted market prices for similar assets or liabilities in active markets;
 - Quoted prices for identical assets or liabilities in inactive markets;
 - Inputs other than quoted prices that are observable for the asset or liability; and
 - Inputs that are derived principally from or corroborated by observable market data by correlation or other means.
- Level 2 - 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.
- 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.

The 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 June 30, 2017 and 2016.

Cash and Invested Cash - The carrying amounts reported in the statement of financial position approximate fair values due to of the short maturities of those instruments.

Accrued Investment Income - The income earned and later reinvested into investments. The carrying amounts reported in the statement of financial position approximate fair values due to the short duration of reinvestment.

Corporate and Fixed Income Securities - Corporate stock and fixed income securities are reported at quoted market prices.

Third Party Trusts - MCH is the beneficiary of numerous trusts managed by independent third parties. In accordance with U.S. generally accepted accounting principles, MCH's beneficial interest in these trusts is recorded at the estimated value of expected future cash receipts. The estimated fair value being used is a capitalization rate of ten times the current year's gross receipts. The change in this value from year to year is reflected in the change in unrealized gains in the statement of activities.

Mineral Rights - From time to time, MCH has been the recipient of mineral rights. These rights are recorded at estimated value at time of receipt or, if not readily available, at a nominal one dollar. In accordance with GAAP, these rights are recorded at their estimated future value as of the date of the financial statements. An independent third party determines this value. The change in the estimated value is reflected in the change of unrealized gains in the statement of activities.

METHODIST CHILDREN'S HOME
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2017 AND 2016

1. Summary of Significant Accounting Policies (Continued)

H. Fair Value Measurements - Continued

Real Estate and Mortgage Loans - From time to time, MCH has been the recipient of real estate. These properties are recorded at the estimated value at the time of receipt.

Mortgage loans and other are recorded at their net cost values.

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

I. Contributions, Investment Income, and Gains Restricted by Donors

MCH reports gifts or investment income and gains as restricted income if it is received with donor stipulation that restricts the gift's use or income to a specific purpose or has a time restriction. When a restriction is met, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restriction. If these restrictions are met in the same period in which the gift or income is earned, the gift or income is recorded as unrestricted support.

J. Grant Income

MCH receives a portion of its revenues from several governmental grant programs offered by both federal and state departments. The monies reimbursed to MCH from these grant programs fluctuates from year to year but it is based upon the amount of services provided for the eligible children associated with those governmental programs. The governmental grant programs that MCH is involved with are the Foster Care program and the National School Breakfast and Lunch program.

K. Property, Buildings and Equipment

According to the MCH capitalization policy, acquisitions of property, buildings, and equipment in excess of \$5,000 are generally capitalized. Property, buildings, and equipment purchased are capitalized at cost as of the date of acquisition. Donated property, buildings, and equipment are capitalized at fair value as of date of contribution. Major renovations of existing property are also capitalized. Regular repair and maintenance are expensed as incurred. Property and equipment are being depreciated over estimated useful lives of 5 to 50 years using a straight-line method as follows:

<u>Assets</u>	<u>Years</u>
Building	10-50
Improvements	10-50
Equipment	5-10
Vehicles	5

METHODIST CHILDREN'S HOME
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2017 AND 2016

1. Summary of Significant Accounting Policies (Continued)

L. Compensated Absences

Effective January 1, 2010, paid time off (PTO) is available for all regularly scheduled full time and part time employees, and begins to accrue the first pay period of employment. At the end of each calendar year, eligible employees may carry over 80 hours of accrued, unused PTO. All unused PTO in excess of 80 hours will be credited to the employee's major medical leave account. Upon termination, any unused PTO is paid to the employee. In addition, the employee is eligible to be paid a percentage of unused major medical. If the employee has 3 years or less of service, they forfeit their unused major medical. Employees with 3 to 5 years of service receive 33.3% of their major medical accrual and employees with 5 years or more of service are paid 50% of their major medical accrual upon voluntary termination.

M. Permanently Restricted Assets

Interpretation of Law

The Board of Directors of MCH has interpreted the Texas Uniform Prudent Management of Institutional Funds Act (TUPMIFA) as requiring the preservation of the purchasing power (real value) of the donor-restricted funds absent explicit donor stipulations to the contrary. As a result of this interpretation, MCH classifies as permanently restricted net assets (1) the original value of gifts donated to the permanently restricted assets, (2) the original value of subsequent gifts to permanently restricted assets, (3) accumulations to the permanently restricted assets made in accordance with the direction of the applicable donor gift instrument at the time of accumulation is added, and (4) the portion of investment return added to the permanently restricted assets to maintain purchasing power. For purposes of determining that portion, each year MCH adjusts permanently restricted net assets by an amount determined to be reasonable for use in the operations but also provide for the change in the average Consumer Price Index (CPI).

Permanently restricted assets have specific restrictions on the how the earnings can be utilized.

As an additional means of assessing and guiding investment results, MCH contracts separately with an investment firm which has the sole task of evaluating the performance of the endowment fund manager and presenting their findings to the Investment Committee of the Board of Directors.

N. Federal Income Tax

MCH is a nonprofit corporation, as described in Section 501(c)(3) of the Internal Revenue Code, and is exempt from federal income taxes. MCH adopted FASB ASC 740-10, *Accounting for Uncertainty in Income Tax*. That standard prescribes a minimum recognition threshold and measurement methodology that a tax position taken or expected to be taken in a tax return is required to meet before being recognized in the financial statements. It also provides guidance for derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. MCH's federal exempt organization returns for the years ended June 30, 2014, and after, are subject to examination by the Internal Revenue Service, generally for three years after they are filed.

METHODIST CHILDREN'S HOME
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2017 AND 2016

1. Summary of Significant Accounting Policies (Continued)

O. Subsequent Events

Management of MCH has evaluated subsequent events for disclosure through the date of the Independent Auditors' Report, the date the financial statements were available to be issued.

2. Concentrations of Credit and Market Risk

Financial instruments which potentially expose MCH to concentrations of credit and market risk consist primarily of invested cash and marketable securities. MCH had realized gains of \$18,232,682 and \$2,598,641 which are reflected in the statements of activities for the years ended June 30, 2017 and 2016, respectively. MCH had cash balances in excess of FDIC coverage of \$6,867,961 at June 30, 2017.

3. Receivables

The following is a breakdown of the accounts receivable balance for MCH as of June 30, 2017 and 2016, respectively:

	2017	2016
Texas Comptroller Office	\$ 132,073	\$ 114,177
Miscellaneous receivables	530	5,087
Total Receivables	\$ 132,603	\$ 119,264

4. Pledges

The following is a breakdown of the pledge receivable balance for MCH as of June 30, 2017 and 2016, respectively:

	2017	2016
Due in less than one year	\$ 409,406	\$ 294,785
Due in one to five years	26,733	161,004
	\$ 436,139	\$ 455,789

Management has determined that the pledges for the years ended June 30, 2017 and 2016, are not fully collectible and have estimated the following allowance for uncollectible pledges. The allowance for doubtful accounts are \$48,531 and \$50,915, for the years ended June 30, 2017 and 2016, respectively. The present value discount are \$643 and \$2,446, for the years ended June 30, 2017 and 2016, respectively.

METHODIST CHILDREN'S HOME
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2017 AND 2016

5. Property and Equipment

The components of fixed assets at cost are:

	2017	2016
Land and improvements	\$ 3,612,279	\$ 3,586,579
Buildings and building improvements	11,764,702	11,614,618
Equipment and furniture	2,403,128	2,550,969
Vehicles	1,525,258	1,583,988
Construction in process	1,706,152	-
Total Fixed Assets	<u>21,011,519</u>	<u>19,336,154</u>
Less: Accumulated Depreciation	<u>(10,345,038)</u>	<u>(9,911,504)</u>
Net Property and Equipment	<u>\$ 10,666,481</u>	<u>\$ 9,424,650</u>

Depreciation expense for the years ended June 30, 2017 and 2016, was \$1,223,152 and 885,406, respectively.

6. Retirement Plan

MCH has a 401(k) safe harbor plan and the plan covers employees with one year of service that includes 1000 hours of service and have reached the age of twenty-one. Under the plan, participants can determine the percentage of annual earnings to contribute and MCH matches contributions up to 6% of the employee deduction. Contributions of MCH for the years ended June 30, 2017 and 2016, were \$752,077 and \$766,084, respectively.

7. Investments

Investments at the end of the year consisted of the following:

Investment Type	June 30, 2017		June 30, 2016	
	Cost Basis	Market Value	Cost Basis	Market Value
Invested cash	\$ 46,811,068	\$ 46,811,068	\$ 10,216,924	\$ 10,216,924
Equity securities	279,408,785	307,095,183	302,099,174	310,803,385
Debt securities	64,446,020	65,260,619	51,761,871	71,641,918
Beneficial interest in trusts	20,134,480	20,134,480	18,397,440	18,397,440
Mineral interests	24,238,071	17,167,581	24,147,043	19,993,179
Real estate	2,196,043	2,196,043	2,196,473	2,196,473
Mortgage loans and others	177,941	177,941	196,848	196,848
Total Investments	<u>\$ 437,412,408</u>	<u>\$ 458,842,915</u>	<u>\$ 409,015,773</u>	<u>\$ 433,446,167</u>

METHODIST CHILDREN'S HOME
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2017 AND 2016

7. Investments (Continued)

Investment income consisted of the following:

	2017	2016
Dividends and interest	\$ 6,627,915	\$ 7,329,009
Mineral rights proceeds	5,469,664	6,283,297
Receipts from trust funds administered by third party trustees	2,002,940	1,839,744
Real estate and other income	268,412	555,322
Total Investment Income	\$ 14,368,931	\$ 16,007,372

Investment expenses consisted of the following:

	2017	2016
Investment advisors / custodian fees	\$ 1,973,732	\$ 1,435,800
Mineral interests	870,028	968,310
Real estate expenses	89,931	49,198
Annuity payments	194,944	129,671
Other expenses	8,162	(3,921)
Total Investment Expenses	\$ 3,136,797	\$ 2,579,058

8. Fair Value Measurement

The following table sets forth by level, within the fair value hierarchy, MCH's assets at fair value as of June 30, 2017 and 2016. Fair value equates to carrying value at June 30, 2017 and 2016, respectively.

Assets at Fair Value as of June 30, 2017

	Level 1	Level 2	Level 3	Total
Cash and invested cash	\$ 46,811,068	\$ -	\$ -	\$ 46,811,068
Corporate and fixed income securities	372,355,802	-	-	372,355,802
Beneficial interest in trusts	-	-	20,134,480	20,134,480
Mineral interests	-	-	17,167,581	17,167,581
Real estate and mortgage loans	-	2,373,984	-	2,373,984
	\$ 419,166,870	\$ 2,373,984	\$ 37,302,061	\$ 458,842,915

METHODIST CHILDREN'S HOME
NOTES TO FINANCIAL STATEMENTS
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8. Fair Value Measurement (Continued)

Assets at Fair Value as of June 30, 2016

	Level 1	Level 2	Level 3	Total
Cash and invested cash	\$ 10,216,924	\$ -	\$ -	\$ 10,216,924
Corporate and fixed income securities	382,445,303	-	-	382,445,303
Beneficial interest in trusts	-	-	18,397,440	18,397,440
Mineral interests	-	-	19,993,179	19,993,179
Real estate and mortgage loans	-	2,393,321	-	2,393,321
	<u>\$ 392,662,227</u>	<u>\$ 2,393,321</u>	<u>\$ 38,390,619</u>	<u>\$ 433,446,167</u>

The following table sets forth a summary of changes in the fair value of MCH's Level 3 assets for the years ended June 30, 2017 and 2016.

	Third Party Trusts	Mineral Interests
Balance, July 1, 2015	\$ 20,897,080	\$ 50,676,261
Purchases, sales, gains, losses (net)	(2,499,640)	(30,683,082)
Balance, June 30, 2016	18,397,440	19,993,179
Purchases, sales, gains, losses (net)	1,737,040	(2,825,598)
Balance, June 30, 2017	<u>\$ 20,134,480</u>	<u>\$ 17,167,581</u>

9. Appropriations to Defined Income

MCH classifies 4.5% of the adjusted board designated endowment fund from the corpus to defined income. The portfolio balance is based on the average of the last twelve calendar quarters.

Defined income is the unrestricted appropriated funds from the board designated endowment fund that have not yet been appropriated to the general operating account.

The changes in defined income for the years ended June 30, 2017 and 2016, are as follows:

	2017	2016
Appropriations from endowment fund	\$ 20,169,000	\$ 19,174,008
Appropriations to general fund	(19,193,572)	(22,178,278)
Net change	975,428	(3,004,270)
Balance at beginning of year	13,729,826	16,734,096
Total Investment Income	<u>\$ 14,705,254</u>	<u>\$ 13,729,826</u>

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10. Net Endowment Assets

The following is an analysis of the activity in the endowment account for the year ended June 30, 2017:

	Unrestricted				Total
	Defined Income	Board Designated Endowment	Temporarily Restricted	Permanently Restricted	
Net Assets, June 30, 2016	\$ 13,729,826	\$ 405,172,656	\$ 5,771,372	\$ 8,150,702	\$ 432,824,556
Investment income	-	13,732,620	562,332	56,685	14,351,637
Investment expenses	-	(3,136,797)	-	-	(3,136,797)
Contributions	-	1,256,738	2,488,113	1,172,891	4,917,742
Appropriated	975,428	(20,169,000)	(2,810,749)	-	(22,004,321)
Realized gains (losses)	-	18,232,682	-	-	18,232,682
Unrealized gains (losses)	-	19,276,498	-	-	19,276,498
Net Assets, June 30, 2017	<u>\$ 14,705,254</u>	<u>\$ 434,365,397</u>	<u>\$ 6,011,068</u>	<u>\$ 9,380,278</u>	<u>\$ 464,461,997</u>

11. Restriction on Net Assets

At June 30, 2017 and 2016, temporarily restricted net assets were restricted for:

	2017	2016
Payments of scholarships	\$ 3,591,523	\$ 3,669,771
Program activities	2,419,545	2,101,601
	<u>\$ 6,011,068</u>	<u>\$ 5,771,372</u>

At June 30, 2017 and 2016, temporarily restricted net assets were released from restrictions for:

	2017	2016
Payments of scholarships	\$ 424,308	\$ 426,935
Program activities	2,386,441	396,624
	<u>\$ 2,810,749</u>	<u>\$ 823,559</u>

At June 30, 2017 and 2016, permanently restricted net assets were restricted for:

	2017	2016
Investments in perpetuity, the income from which is expendable to support scholarship and future operations	<u>\$ 9,380,278</u>	<u>\$ 8,150,702</u>

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12. Gift Annuities

From time to time MCH receives gift annuities from donors. Quarterly payments are made until the donor passes, at which time MCH may recognize the remaining portion of the annuity as contribution revenue.

During the years ended June 30, 2017 and 2016, MCH received \$215,000 and \$25,000 in new gift annuities, made payments of \$133,025 and \$129,671 and recognized the remaining portion of gift annuities of \$0 and \$449,830, respectively.

Gift annuities are calculated at present value using a discount rate that ranges from 5.1% - 15.4% depending on that specific annuity agreement and published life expectancy tables. Estimated minimum gift annuities payments due under the donor agreements are as follows:

<u>Years ending June 30,</u>	
2018	\$ 138,361
2019	138,361
2020	138,361
2021	138,361
2022	138,361
Other	<u>111,924</u>
Total	<u><u>\$ 803,729</u></u>

13. Operating Leases

MCH leases properties in Texas and New Mexico and related office equipment, which serve as offices for its foster care and outreach programs. Minimum rents due under the leasing agreements are as follows:

<u>Years ending June 30,</u>	
2018	\$ 452,755
2019	388,259
2020	294,363
2021	157,929
2022	52,500
Thereafter	<u>96,250</u>
Total	<u><u>\$ 1,442,056</u></u>

Rent expense for the years ended June 30, 2017 and 2016, was \$465,275 and \$398,916, respectively.