The Council on Recovery and
The Foundation for The Council on Recovery

Consolidated Financial Statements
and Independent Auditors' Report
for the year ended August 31, 2016

The Council on Recovery and The Foundation for The Council on Recovery

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Blazek & Vetterling

CERTIFIED PUBLIC ACCOUNTANTS

Independent Auditors' Report

To the Board of Trustees of
The Council on Recovery:

We have audited the accompanying financial statements of The Council on Recovery and The Foundation for The Council on Recovery, which comprise the consolidated statement of financial position as of August 31, 2016 and the related consolidated statements of activities, of functional expenses, and of cash flows for the year then ended, and the related notes to the financial statements.

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

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

Basis for Qualified Opinion – Austin Recovery, Inc. was a controlled affiliate of The Council on Recovery until January 22, 2016 when a separation agreement transferred control to an independent Board of Trustees. Accounting principles generally accepted in the United States of America require that the consolidated financial statements reflect the activities of Austin Recovery, Inc. and the effect of the separation through the date that The Council on Recovery no longer held control. These financial statements do not include any of the activities of Austin Recovery, Inc. or any of the adjustments to recognize the deconsolidation. While the gross effects on the accompanying financial statements have not been determined, there is no net impact on consolidated net assets at August 31, 2016.

Qualified Opinion – In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of The Council on Recovery and The Foundation for The Council on Recovery as of August 31, 2016 and the changes in their net assets and their cash flows for the year ended in accordance with accounting principles generally accepted in the United States of America.

Blazek & Vetterling

January 31, 2017

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The Council on Recovery and The Foundation for The Council on Recovery

Consolidated Statement of Financial Position as of August 31, 2016

ASSETS

Cash and cash equivalents *(Note 2)*	$ 1,542,987
Accounts receivable:	
The Harris Center for Mental Health and IDD	274,415
Texas Department of State Health Services	53,577
Clients, net	116,712
Other government contracts	41,401
Other	44,415
Prepaid expenses and other assets	103,411
Pledges receivable, net *(Note 3)*	711,664
Property and equipment, net *(Note 4)*	10,564,613
Money market mutual funds to support speaker series	113,600
TOTAL ASSETS	$ 13,566,795

LIABILITIES AND NET ASSETS

Liabilities:	
Accounts payable and accrued expenses	$ 158,755
Deferred revenue:	
Special events	385,635
Services and fees	79,916
Note payable *(Note 5)*	144,957
Total liabilities	769,263
Net assets:	
Unrestricted	11,498,277
Temporarily restricted *(Note 6)*	1,185,655
Permanently restricted to support speaker series	113,600
Total net assets	12,797,532
TOTAL LIABILITIES AND NET ASSETS	$ 13,566,795

See accompanying notes to consolidated financial statements.

The Council on Recovery and The Foundation for The Council on Recovery

Consolidated Statement of Activities for the year ended August 31, 2016

	UNRESTRICTED	TEMPORARILY RESTRICTED	PERMANENTLY RESTRICTED	TOTAL
REVENUE:				
Government grants and fees *(Note 7)*	$ 5,354,463			$ 5,354,463
Contributions:				
United Way		$ 483,063		483,063
Other	610,735	1,778,722		2,389,457
Special events	855,840			855,840
Cost of direct donor benefits at special events	(75,292)			(75,292)
Program service fees, net	848,838			848,838
Building rental	40,280			40,280
Other income	18,842			18,842
Total revenue	7,653,706	2,261,785		9,915,491
Net assets released from restrictions:				
Expenditures for program purposes	1,704,790	(1,704,790)		
Total	9,358,496	556,995		9,915,491
EXPENSES:				
Program services:				
Recovery services	5,004,171			5,004,171
Prevention and education	2,496,035			2,496,035
Total program services	7,500,206			7,500,206
Supporting services:				
Management and general	1,329,624			1,329,624
Fundraising	548,227			548,227
Total supporting services	1,877,851			1,877,851
Cost of support provided to Austin Recovery, net	474,992			474,992
Total expenses	9,853,049			9,853,049
CHANGES IN NET ASSETS	(494,553)	556,995		62,442
Net assets, beginning of year	11,992,830	628,660	$ 113,600	12,735,090
Net assets, end of year	$ 11,498,277	$ 1,185,655	$ 113,600	$ 12,797,532

See accompanying notes to consolidated financial statements.

The Council on Recovery and The Foundation for The Council on Recovery

Consolidated Statement of Functional Expenses for the year ended August 31, 2016

	PROGRAM SERVICES		SUPPORTING SERVICES		
	RECOVERY SERVICES	PREVENTION AND EDUCATION	MANAGEMENT AND GENERAL	FUNDRAISING	TOTAL
Salaries	$ 3,319,170	$ 1,400,911	$ 863,887	$ 262,692	$ 5,846,660
Benefits and payroll taxes	846,227	373,604	122,265	37,162	1,379,258
Total salaries and related expenses	4,165,397	1,774,515	986,152	299,854	7,225,918
Professional fees	74,666	78,778	140,407	148,845	442,696
Depreciation	161,653	169,192	19,763	7,279	357,887
Occupancy	173,061	132,967	34,494	10,099	350,621
Supplies	81,338	91,916	45,243	45,130	263,627
Travel	78,570	54,480	14,804	3,702	151,556
Participant activities and incentives	44,324	67,865			112,189
Software licensing and maintenance	50,791	26,006	15,829	7,787	100,413
Communications	50,783	30,269	12,790	3,182	97,024
Insurance	29,435	16,710	17,608	1,669	65,422
Bad debt expense	44,953	225			45,178
Promotions and advertising	27	22,224	18,778	2,095	43,124
Training	8,976	13,809	2,488	191	25,464
Credit card processing fees	16,245	1,372		7,843	25,460
Equipment rental and maintenance	9,567	10,844	1,311	425	22,147
Postage and shipping	889	458	253	9,789	11,389
Vehicle	201	247	8,699	9	9,156
Interest			6,861		6,861
Dues and license fees	4,126	1,947	640	108	6,821
Other	9,169	2,211	3,504	220	15,104
Total expenses	$ 5,004,171	$ 2,496,035	$ 1,329,624	$ 548,227	9,378,057
Cost of support provided to Austin Recovery, net					474,992
Cost of direct donor benefits at special events					75,292
Total					$ 9,928,341

See accompanying notes to consolidated financial statements.

The Council on Recovery and The Foundation for The Council on Recovery

Consolidated Statement of Cash Flows for the year ended August 31, 2016

CASH FLOWS FROM OPERATING ACTIVITIES:	
Changes in net assets	$ 62,442
Adjustments to reconcile changes in net assets to net cash provided by operating activities:	
Depreciation	357,887
Changes in operating assets and liabilities:	
Accounts receivable	66,438
Prepaid expenses and other assets	35,212
Pledges receivable	(434,654)
Accounts payable and accrued expenses	(26,032)
Deferred revenue	67,068
Net cash provided by operating activities	128,361
CASH FLOWS FROM INVESTING ACTIVITIES:	
Purchases of property and equipment	(34,385)
CASH FLOWS FROM FINANCING ACTIVITIES:	
Principal payments on note payable	(46,442)
NET CHANGE IN CASH AND CASH EQUIVALENTS	47,534
Cash and cash equivalents, beginning of year	1,495,453
Cash and cash equivalents, end of year	$ 1,542,987

See accompanying notes to consolidated financial statements.

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization – Houston Council on Alcoholism and Drug Abuse, Inc. conducts business as The Council on Recovery (The Council) (formerly known as The Council on Alcohol and Drugs Houston) and is a Texas nonprofit corporation formed to keep the community healthy, productive, and safe by providing services and information to all who may be adversely affected by alcohol and drugs. The Council's programs are operated primarily in the Greater Houston area.

The Foundation for The Council on Recovery (The Foundation), a financially-interrelated organization, is a nonprofit corporation founded in 1986 to support The Council in fulfilling its mission. The Board of Trustees of The Foundation is appointed by the Board of Trustees of The Council.

Austin Recovery, Inc. (Austin Recovery) is a Texas nonprofit corporation created in 1967. Austin Recovery's mission is to provide effective, affordable, and compassionate treatment for chemical dependency. Austin Recovery provides alcohol and drug treatment, assessment, medical detoxification, men's and women's residential programs, an outpatient program, a program for women with children, a family program, an aftercare and an alumni program. Austin Recovery's programs are operated primarily in and around Austin, Texas.

In January 2016, the Board of Trustees authorized the separation of Austin Recovery from The Council, effective January 22, 2016, resulting in Austin Recovery resuming use of its corporate name, establishing a separate Board of Trustees and adopting new bylaws. In connection with the separation, The Council and Austin Recovery have entered into a mutual release and indemnity agreement indemnifying each other against existing and future claims against the other.

The Council and The Foundation's consolidated net assets at September 1, 2015 have been decreased by approximately $6.9 million to exclude the net assets of Austin Recovery. The Council provided supporting services to Austin Recovery as The Foundation for The Council on Recovery through the date of separation and continued to provide supporting services to assist Austin Recovery in the transition. These costs, net of reimbursements of approximately $31,000, are reflected in the statement of activities.

Basis of consolidation – These financial statements include only the assets, liabilities, net assets, and activities of The Council and The Foundation (collectively the Consolidated Entities). Balances and transactions between the Consolidated Entities have been eliminated in consolidation.

Program services – The Council provides services in 50 different locations in and around Houston, Texas through the following programs:

Recovery services: The specific services included are confidential screenings and diagnostic assessments; individual, family and group counseling; aftercare; intervention; psychoeducation; intensive outpatient treatment for adults; and case management services for individuals and families. Children's therapists also provide play therapy, parent coaching and Kids Camp at The Council – a 4-day prevention and support program. For teens who are experimenting with alcohol/drugs and other unsafe behaviors, we provide a "high-risk behavior class." The caregivers of these teens participate in a similar class that provides them with the same information their children receive, as well as parenting skills and support. Additionally, teens who have moved beyond experimentation and are diagnosed with a substance abuse disorder or are experiencing significant family, school and legal issues as a result of their behaviors, participate in individual, family and/or group therapy.

Case managers provide services to pregnant and parenting women in The Council offices, in client's homes and in various community sites including schools, shelters, clinics and multi-service centers. These services include intensive case management, parenting classes, crisis intervention, and substance abuse education. The goal is to enhance the women's and children's lives and keep families intact. Specifically, these services help women deliver healthy babies, develop positive parenting skills, and become and remain sober.

The Council also serves as the primary access point for state-funded, residential treatment services for alcohol and/or drug addiction. Counselors screen each client for substance use and financial eligibility, provide motivational interviewing and refer clients to the appropriate care. Other clinical services offered in the community are provided to clients of The Harris Center for Mental Health and IDD (formerly Mental Health and Mental Retardation Authority of Harris County) at their clinics. These services are therapeutic and specifically designed for people with serious mental illness who are abusing alcohol and/or other drugs.

Prevention and education: The goals of The Council's prevention and education programs are (a) to cultivate individual and community awareness about the dangerous effects and often fatal consequences of substance use and abuse; and (b) decrease risk factors and increase protective factors that have been shown to prevent substance abuse. The Council provides prevention services in elementary and middle schools, focusing on the development of life skills. Prevention specialists also facilitate an evidence-based peer support program for higher risk middle school students. For high school students, staff conduct a substance abuse and dropout prevention/intervention program. The elementary and middle school programs are also offered in the summer at camps in the Houston area. Drug Free Youth, another prevention/intervention program, also is provided to youth involved in the juvenile justice system. The Council also educates older adults and their care providers about the increased risk of alcohol and drug abuse due to the potential need for addictive pain medications and a lack of understanding of the effects of alcohol on people as they age.

Community education services include workshops and lectures for the public that address addiction issues, other compulsive behaviors, co-occurring mental health disorders, as well as the challenges and successful approaches to treatment and recovery. Additionally, The Council provides recovery support services, through specially designed meetings and events (educational, social, supportive) and by providing meeting space for a variety of 12-step and other support programs.

<u>Federal income tax status</u> – The Consolidated Entities are exempt from federal income tax under §501(c)(3) of the Internal Revenue Code. The Council is classified as a public charity under §509(a)(1) and §170(b)(1)(A)(vi). The Foundation is classified as a Type I supporting organization under §509(a)(3).

<u>Cash and cash equivalents</u> include demand deposits with original maturities of three months or less, except that cash and cash equivalents restricted for long-term purposes are reported separately. Non-negotiable certificates of deposit are reported at face value.

<u>Client accounts receivable</u> are uncollateralized client obligations from clients and third-party payors and are net of allowances for contractual adjustments and of uncollectible accounts of approximately $129,000 at August 31, 2016. There is no policy to charge interest on past due accounts. In evaluating the collectability of client accounts receivable, management evaluates its past history and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for uncollectible accounts and provision for uncollectible accounts. Client accounts receivable balances are written off against the allowance when management determines a receivable will not be collected. It is possible that management's estimate regarding the collectability of these balances will change in the near term resulting in a change in the carrying value of client accounts receivable.

<u>Pledges receivable</u> that are expected to be collected within one year are reported at net realizable value. Amounts expected to be collected in more than one year are discounted, if material, to estimate the present value of future cash flows. An allowance for uncollectible pledges is provided when it is believed balances may not be collected in full. Pledge balances are written off against the allowance when management determines a pledge will not be collected. The loss on pledges recognized each period and the resulting adequacy of the allowance at the end of each period are determined using a combination of historical loss experience and individual account-by-account analysis of pledge balances.

<u>Property and equipment</u> with a cost of more than $5,000 are reported at cost if purchased or at fair value at the date of gift if donated. Depreciation is provided on a straight-line basis over estimated useful lives of 20 to 40 years for buildings and improvements and 3 to 10 years for furniture and equipment.

<u>Net asset classification</u> – Contributions and the related net assets are classified based on the existence or absence of donor-imposed restrictions, as follows:

- *Unrestricted net assets* include those net assets whose use is not restricted by donor-imposed stipulations, even though their use may be limited in other respects, such as by contract or board designation.

- *Temporarily restricted net assets* include contributions restricted by the donor for specific purposes or time periods. When a purpose restriction is accomplished or a time restriction ends, temporarily restricted net assets are released to unrestricted net assets.
- *Permanently restricted net assets* include contributions that donors have restricted in perpetuity. Permanently restricted net assets are invested to support The Waggoners Foundation Speaker Series.

Government grants and fees are recognized as the related services are provided.

Contributions are recognized as revenue at fair value when an unconditional commitment is received from the donor. Contributions received with donor stipulations that limit their use are classified as restricted support. Conditional contributions are recognized in the same manner when the conditions are substantially met.

Special events revenue is recognized when the event occurs. Conditional contributions received for future events are reported in the statement of financial position as deferred revenue. Cost of direct donor benefits represent the cost of goods and services provided to attendees of special events.

Program service fees are recognized as revenue at the estimated net realizable amounts from clients, third-party payors and others when the services are provided. Amounts reimbursed for services rendered to clients covered under Medicare and other third-party payor programs are generally at amounts different than the established billing rates. Differences between the established rates and amounts reimbursed are recognized as contractual adjustments during the period in which the related services are provided. Fees are charged to clients on a sliding-scale basis. Differences between established rates and amounts charged to clients are recognized as sliding-scale fee adjustments in the period in which the related services are provided. Program service fees are presented net of contractual and sliding-scale fee adjustments of approximately $680,000 for the year ended August 31, 2016.

Estimates – Management must make estimates and assumptions to prepare financial statements in accordance with generally accepted accounting principles. These estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, the amounts reported as revenue and expenses, and the allocation of expenses among various functions. Actual results could vary from the estimates that were used.

Recent financial accounting pronouncement – In August 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities.* The amendments in this ASU are the first phase of changes aimed at providing more useful information to users of not-for-profit financial statements. Under this ASU, net assets will be presented in two classes: *net assets with donor restrictions* and *net assets without donor restrictions* and underwater endowments will be grouped with *net assets with donor restrictions.* New or enhanced disclosures will be required about the nature and composition of net assets, and the liquidity and availability of resources for general operating expenditures within one year of the balance sheet date. Expenses will be required to be presented by both nature and function and investment return will be presented net of external and direct internal investment expenses. The ASU is effective for fiscal periods beginning after December 15, 2017, but early adoption is permitted. Adoption of this ASU will significantly impact the presentation and disclosures of the financial statements. The Council will adopt this ASU effective for the fiscal year ending August 31, 2019.

NOTE 2 – CASH AND CASH EQUIVALENTS

Cash and cash equivalents at August 31, 2016 consist of the following:

Non-negotiable certificates of deposit	$ 600,046
Money market mutual funds	487,188
Demand deposits	455,753
Total cash and cash equivalents	$ 1,542,987

Demand deposits exceed the federally insured limit per depositor per institution.

NOTE 3 – PLEDGES RECEIVABLE

Pledges receivable at August 31, 2016 consist of the following:

Pledges receivable from United Way	$ 160,436
Pledges receivable from others	611,814
Total pledges receivable	772,250
Allowance for uncollectible accounts	(60,586)
Pledges receivable, net	$ 711,664

Pledges receivable at August 31, 2016 are expected to be collected as follows:

2017	$ 653,500
2018	91,250
2019	27,500
Total pledges receivable	$ 772,250

Concentration – At August 31, 2016, approximately 87% of pledges receivable from others are due from three donors.

NOTE 4 – PROPERTY AND EQUIPMENT

Property and equipment at August 31, 2016 consists of the following:

Land	$ 728,359
Buildings and improvements	13,273,190
Furniture and equipment	689,315
Total property and equipment, at cost	14,690,864
Accumulated depreciation	(4,126,251)
Property and equipment, net	$ 10,564,613

NOTE 5 – NOTE PAYABLE

During August 2013, The Council borrowed $279,763 from a bank to fund a pension plan termination liability. The liability arose from the termination of a multi-employer, cash balance defined benefit pension plan sponsored by the United Way of Greater Houston (United Way) in which The Council participated prior to its termination in 2013. The note bears interest at 3.5% and is payable in monthly installments of $4,375 of principal and interest through August 2019 when all outstanding principal and unpaid accrued interest is due. The note is subject to certain financial covenants including a prohibition against additional debt. The note is guaranteed by United Way.

Principal payments at August 31, 2016 are due as follows:

2017	$ 48,205
2018	49,920
2019	46,832
Total note payable	$ 144,957

In March 2016, The Council acquired a line of credit with a bank in the amount of $750,000. The note payable described above included a prohibition against additional debt. The Council obtained a waiver from that bank allowing The Council to be obligated under the line of credit. At August 31, 2016, no balance was outstanding on this line of credit.

NOTE 6 – TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets at August 31, 2016 are available for the following purposes:

Recovery services	$ 476,510
Integrated Care Initiative	416,302
Prevention and education	292,843
Total temporarily restricted net assets	$ 1,185,655

NOTE 7 – GOVERNMENT GRANTS AND FEES

The Council is the recipient of government contracts from federal, state, and local agencies. Should these contracts not be renewed, a replacement for this source of support may not be forthcoming and related expenses would not be incurred. Government grants and fees recognized during the year ended August 31, 2016 are as follows:

The Harris Center for Mental Health and IDD	$ 2,825,865
Texas Department of State Health Services	2,271,314
Harris County, Texas	242,513
Other	14,771
Total government grants and fees	$ 5,354,463

Grants from federal, state, and local government funding sources require fulfillment of certain conditions as set forth in the grant contracts and are subject to review and audit by the awarding agencies. Such reviews and audits could result in the discovery of unallowable activities and unallowable costs. Consequently, any of the funding sources may, at their discretion, request reimbursement for expenses or return of funds as a result of non-compliance with the terms of the contracts. Management believes such disallowances, if any, would not be material to The Council's financial position or changes in net assets.

NOTE 8 – EMPLOYEE BENEFIT PLAN

The Council provides a §403(b) defined contribution retirement plan. Employees may elect to participate in the §403(b) plan at the time of hire or at the beginning of any subsequent calendar quarter, if eligible. The Council makes a matching contribution equal to 100% of the employee's contribution up to a maximum of 4% of compensation. Contributions to the §403(b) plan totaled approximately $147,000 for the year ended August 31, 2016.

NOTE 9 – SUBSEQUENT EVENTS

Management has evaluated subsequent events through January 31, 2017, which is the date that the financial statements were available for issuance. As a result of this evaluation, no events were identified that are required to be disclosed or would have a material impact on reported net assets or changes in net assets.