# MORNINGSIDE MINISTRIES AND SUBSIDIARIES

## CONSOLIDATED FINANCIAL STATEMENTS
## AND SUPPLEMENTARY INFORMATION

## YEARS ENDED DECEMBER 31, 2018 AND 2017

**MORNINGSIDE MINISTRIES AND SUBSIDIARIES**
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**YEARS ENDED DECEMBER 31, 2018 AND 2017**

# INDEPENDENT AUDITORS' REPORT

Board of Directors
Morningside Ministries and Subsidiaries
San Antonio, Texas

## Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Morningside Ministries and Subsidiaries, (a Texas corporation), which comprise the consolidated balance sheets as of December 31, 2018 and 2017, and the related consolidated statements of operations, changes in net assets, functional expenses, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

### *Management's Responsibility for the Consolidated Financial Statements*

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

### *Auditors' Responsibility*

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Board of Directors
Morningside Ministries and Subsidiaries

***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Morningside Ministries and Subsidiaries as of December 31, 2018 and 2017, and the results of their operations, changes in their net assets, and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

***Emphasis-of-Matter Regarding a Change in Accounting Principle***

As discussed in Note 2 to the financial statements, Morningside Ministries and Subsidiaries adopted a provision of Financial Accounting Standards Board Accounting Standards Updates 2016-14, *Presentation of Financial Statements for Not-for-Profit Entities*. The new accounting standard changes the presentation of various classifications and disclosures within the consolidated financial statements. Our opinion is not modified with respect to that matter.

As discussed in Note 2 to the financial statements, Morningside Ministries and Subsidiaries early adopted a provision of Financial Accounting Standards Board Accounting Standards Updates 2014-09, *Revenue from Contracts with Customers*. The new accounting standard clarifies how revenue is to be recognized and requires expanded disclosures related to the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Our opinion is not modified with respect to that matter.

**Report on Supplementary Information**

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating balance sheet, and the statements of operations and changes in net assets on pages 38 – 41 are presented for purposes of additional analysis of the consolidated financial statements and are not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

CliftonLarsonAllen LLP

**CliftonLarsonAllen LLP**

Dallas, Texas
April 16, 2019

**MORNINGSIDE MINISTRIES AND SUBSIDIARIES**
**CONSOLIDATED BALANCE SHEETS**
**DECEMBER 31, 2018 AND 2017**

| | 2018 | 2017 |
|---|---|---|
| **ASSETS** | | |
| **CURRENT ASSETS** | | |
| Cash and Cash Equivalents | $ 8,074,417 | $ 9,651,459 |
| Resident Accounts Receivable, Net | 1,737,218 | 3,275,898 |
| Accounts Receivable, Other | 9,705 | 3,000 |
| Current Portion of Assets Limited as to Use | 2,095,208 | 2,041,187 |
| Supplies | 362,312 | 382,258 |
| Prepaid Expenses | 483,935 | 634,606 |
| Total Current Assets | 12,762,795 | 15,988,408 |
| **INVESTMENTS** | 20,430,725 | 23,959,454 |
| **ASSETS LIMITED AS TO USE** | | |
| Cash and Cash Equivalents - Trustee Held | 2,095,209 | 2,048,971 |
| Debt Service Reserve Fund | 3,548,238 | 3,548,238 |
| Endowment, Purpose, and Time Restricted Investments | 15,993,508 | 19,285,296 |
| Total Assets Limited as to Use | 21,636,955 | 24,882,505 |
| Less: Current Portion of Assets Limited as to Use | (2,095,208) | (2,041,187) |
| Total Assets Limited as to Use, Net of Current Portion | 19,541,747 | 22,841,318 |
| **PROPERTY, PLANT, AND EQUIPMENT** | 154,600,367 | 154,612,721 |
| Less: Accumulated Depreciation | (66,725,000) | (63,718,309) |
| Property, Plant, and Equipment, Net | 87,875,367 | 90,894,412 |
| **OTHER ASSETS** | | |
| Deposits | 70,000 | 70,000 |
| Home Health License | 251,750 | 250,000 |
| Other Assets | 20,800 | 20,800 |
| Total Other Assets | 342,550 | 340,800 |
| Total Assets | $ 140,953,184 | $ 154,024,392 |

*See accompanying Notes to Consolidated Financial Statements.*

**MORNINGSIDE MINISTRIES AND SUBSIDIARIES**
**CONSOLIDATED BALANCE SHEETS (CONTINUED)**
**DECEMBER 31, 2018 AND 2017**

| | 2018 | 2017 |
|---|---|---|
| **LIABILITIES AND NET ASSETS** | | |
| **CURRENT LIABILITIES** | | |
| Current Maturities of Long-Term Debt | $ 949,855 | $ 1,282,530 |
| Accounts Payable | 1,050,818 | 1,176,318 |
| Accrued Wages and Related Costs | 1,006,504 | 1,254,054 |
| Accrued Insurance Cost | 127,131 | 111,748 |
| Accrued Interest Payable | 1,581,329 | 1,506,187 |
| Accrued Expenses | 56,468 | 108,960 |
| Total Current Liabilities | 4,772,105 | 5,439,797 |
| **LONG-TERM LIABILITIES** | | |
| Resident Deposits | 66,935 | 99,594 |
| Refundable Entrance Fee Payable | 29,592,005 | 27,507,103 |
| Deferred Revenue | 4,057,412 | 3,818,459 |
| Long-Term Debt, Net | 72,955,777 | 73,521,323 |
| Total Long-Term Liabilities | 106,672,129 | 104,946,479 |
| Total Liabilities | 111,444,234 | 110,386,276 |
| **NET ASSETS** | | |
| Without Donor Restrictions: | | |
| Undesignated | 13,434,266 | 24,363,363 |
| Noncontrolling Interest (Deficit) | 81,174 | (10,544) |
| Total Without Donor Restrictions | 13,515,440 | 24,352,819 |
| With Donor Restrictions: | | |
| Purpose Restrictions | 565,201 | 3,057,379 |
| Time Restrictions | 3,132,887 | 4,250,271 |
| Perpetual Endowment Funds | 12,295,422 | 11,977,647 |
| Total With Donor Restrictions | 15,993,510 | 19,285,297 |
| Total Net Assets | 29,508,950 | 43,638,116 |
| Total Liabilities and Net Assets | $ 140,953,184 | $ 154,024,392 |

*See accompanying Notes to Consolidated Financial Statements.*

## MORNINGSIDE MINISTRIES AND SUBSIDIARIES
## CONSOLIDATED STATEMENTS OF OPERATIONS
## YEARS ENDED DECEMBER 31, 2018 AND 2017

| | 2018 | 2017 |
|---|---|---|
| **WITHOUT DONOR RESTRICTIONS REVENUES** | | |
| Net Resident Service Revenue | $ 24,389,159 | $ 30,056,571 |
| Rental Income | 933,333 | 1,012,500 |
| Management Fee Revenue | 13,593,660 | 15,039,877 |
| Incentive Revenue | 39,432 | 75,900 |
| Amortization of Advance Entrance Fee Revenue | 487,839 | 438,855 |
| Other Operating Revenue | 555,078 | 930,009 |
| Net Assets Released from Restrictions - Operations | 753,437 | 777,100 |
| Total Operating Revenue | 40,751,938 | 48,330,812 |
| | | |
| **OPERATING EXPENSES** | | |
| Nursing Services | 11,705,613 | 14,735,126 |
| Food Services | 5,596,591 | 6,113,281 |
| Environmental Services | 6,524,511 | 7,163,694 |
| Ancillary Services | 5,328,256 | 6,856,399 |
| Life Enrichment | 1,147,222 | 1,242,348 |
| Training Institutes and Other | 298,386 | 327,215 |
| General and Administrative | 8,326,534 | 9,411,091 |
| Depreciation | 5,284,477 | 5,261,901 |
| Interest | 4,082,377 | 3,777,775 |
| Total Operating Expenses | 48,293,967 | 54,888,831 |
| | | |
| **NET LOSS FROM OPERATIONS** | (7,542,029) | (6,558,019) |
| | | |
| **OTHER INCOME (EXPENSE)** | | |
| Unrestricted Investment Earnings, Net of Fees | (744,188) | 3,540,490 |
| Unrestricted Contributions | 111,316 | 180,878 |
| Gain (Loss) on Sale of Property and Equipment | 38,197 | (34,179) |
| Total Other Income (Expense) | (594,675) | 3,687,189 |
| | | |
| **DEFICIT OF REVENUES OVER EXPENSES** | $ (8,136,704) | $ (2,870,830) |

*See accompanying Notes to Consolidated Financial Statements.*

**MORNINGSIDE MINISTRIES AND SUBSIDIARIES**
**CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS**
**YEARS ENDED DECEMBER 31, 2018 AND 2017**

| | 2018 | 2017 |
|---|---|---|
| **NET ASSETS WITHOUT DONOR RESTRICTIONS** | | |
| Deficit of Revenues Over Expenses | $ (8,136,704) | $ (2,870,830) |
| Member Contribution | - | 33,704 |
| Forfeiture of Chandler Trusts - Fair Market Value | (2,729,874) | - |
| Net Assets Released from Restrictions - Capital | 29,199 | 95,078 |
| Decrease in Net Assets Without Donor Restrictions | (10,837,379) | (2,742,048) |
| | | |
| **NET ASSETS WITH DONOR RESTRICTIONS - PURPOSE RESTRICTIONS** | | |
| Contributions | 169,469 | 370,970 |
| Forfeiture of Chandler Trusts - Corpus | (2,350,612) | - |
| Net Assets Released from Restrictions - Operations | (281,836) | (355,900) |
| Net Assets Released from Restrictions - Capital | (29,199) | (95,078) |
| Decrease in Net Assets With Donor Restrictions - Purpose Restrictions | (2,492,178) | (80,008) |
| | | |
| **NET ASSETS WITH DONOR RESTRICTIONS - TIME RESTRICTIONS** | | |
| Gain (Loss) on Endowment Investments | (469,842) | 1,998,858 |
| Forfeiture of Chandler Trusts - Corpus | (175,941) | - |
| Net Assets Released from Restrictions - Operations | (471,601) | (421,200) |
| Increase (Decrease) in Net Assets With Donor Restrictions - Time Restrictions | (1,117,384) | 1,577,658 |
| | | |
| **NET ASSETS WITH DONOR RESTRICTIONS - PERPETUAL ENDOWMENT FUNDS** | | |
| Contributions | 317,775 | 96,007 |
| Increase in Net Assets With Donor Restrictions - Perpetual Endowment Funds | 317,775 | 96,007 |
| | | |
| **DECREASE IN NET ASSETS** | (14,129,166) | (1,148,391) |
| | | |
| Net Assets - Beginning of Year | 43,638,116 | 44,786,507 |
| | | |
| **NET ASSETS - END OF YEAR** | $ 29,508,950 | $ 43,638,116 |

# MORNINGSIDE MINISTRIES AND SUBSIDIARIES
# CONSOLIDATED STATEMENTS OF FUNCTIONAL EXPENSES
# YEAR ENDED DECEMBER 31, 2018

| | Program Services | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Nursing | Food | Environmental | Ancillary | Life Enrichment | Training Institute and Other | Total Program Services | Administrative and Fundraising | Total |
| Salaries | $ 8,700,209 | $ 2,879,065 | $ 2,369,716 | $ 1,672,761 | $ 772,568 | $ 158,608 | $ 16,552,927 | $ 3,501,841 | $ 20,054,768 |
| Percentages | 43.38% | 14.36% | 11.82% | 8.34% | 3.85% | 0.79% | 82.54% | 17.46% | 100.00% |
| Employee Insurance and Payroll Taxes | 1,202,558 | 397,949 | 327,546 | 231,212 | 106,786 | 21,923 | 2,287,974 | 484,031 | 2,772,005 |
| Retirement Benefits | 46,218 | 15,294 | 12,589 | 8,886 | 4,104 | 843 | 87,934 | 18,603 | 106,537 |
| Total Salaries, Insurance, Payroll Taxes, and Benefits | 9,948,985 | 3,292,309 | 2,709,851 | 1,912,859 | 883,458 | 181,374 | 18,928,836 | 4,004,474 | 22,933,310 |
| Bank Fees | - | - | - | - | - | - | - | 8,950 | 8,950 |
| Bad Debt Expense | - | - | - | - | - | - | - | 390,000 | 390,000 |
| Development | - | - | - | - | - | - | - | 302,452 | 302,452 |
| Drugs | - | - | - | 2,055,830 | - | - | 2,055,830 | - | 2,055,830 |
| Dues and Subscriptions | - | - | - | - | - | - | - | 67,932 | 67,932 |
| Food | - | 1,894,205 | - | - | - | - | 1,894,205 | - | 1,894,205 |
| Insurance | - | - | - | - | - | 23,204 | 23,204 | 434,039 | 457,243 |
| Licenses | 1,058 | - | 21,627 | - | - | - | 22,685 | 7,565 | 30,250 |
| Medical Expenses | - | - | - | 310,713 | - | - | 310,713 | - | 310,713 |
| mmCare. LLC | 349,376 | - | 16,500 | 608,654 | 37,107 | - | 1,011,637 | 647,779 | 1,659,416 |
| Other | - | - | - | 11,298 | - | - | 11,298 | 438,394 | 449,692 |
| Plant Operation and Maintenance | 36,906 | - | 636,799 | 35,681 | - | - | 709,386 | - | 709,386 |
| Postage | - | - | - | 12,058 | - | - | 12,058 | 51,382 | 63,440 |
| Professional Fees and Contract Services | 837,083 | 18,961 | 267,166 | 325,545 | - | 68,144 | 1,516,899 | 1,610,578 | 3,127,477 |
| Security | - | - | 8,574 | - | - | - | 8,574 | - | 8,574 |
| Staff Development | - | - | - | - | - | 18,211 | 18,211 | 141,527 | 159,738 |
| Supplies | 532,205 | 391,116 | 590,528 | 55,618 | 226,657 | 3,156 | 1,799,280 | 82,058 | 1,881,338 |
| Strategic Planning | - | - | - | - | - | - | - | - | - |
| Telephone | - | - | - | - | - | 613 | 613 | 83,777 | 84,390 |
| Travel | - | - | - | - | - | 3,684 | 3,684 | 55,627 | 59,311 |
| Utilities | - | - | 2,238,736 | - | - | - | 2,238,736 | - | 2,238,736 |
| Vehicle and Transportation | - | - | 34,730 | - | - | - | 34,730 | - | 34,730 |
| Total Other Expenses | 1,756,628 | 2,304,282 | 3,814,660 | 3,415,397 | 263,764 | 117,012 | 11,671,743 | 4,322,060 | 15,993,803 |
| Sub-Total | 11,705,613 | 5,596,591 | 6,524,511 | 5,328,256 | 1,147,222 | 298,386 | 30,600,579 | 8,326,534 | 38,927,113 |
| Depreciation | 2,291,852 | 758,418 | 624,242 | 440,647 | 203,514 | 41,781 | 4,360,455 | 924,022 | 5,284,477 |
| Interest | 1,771,027 | 586,067 | 482,383 | 340,510 | 157,265 | 32,286 | 3,369,537 | 712,840 | 4,082,377 |
| Total Year Ended December 31, 2018 | $ 15,768,493 | $ 6,941,075 | $ 7,631,136 | $ 6,109,413 | $ 1,508,001 | $ 372,453 | $ 38,330,570 | $ 9,963,397 | $ 48,293,967 |

# MORNINGSIDE MINISTRIES AND SUBSIDIARIES
# CONSOLIDATED STATEMENTS OF FUNCTIONAL EXPENSES (CONTINUED)
# YEAR ENDED DECEMBER 31, 2017

| | Program Services | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Nursing | Food | Environmental | Ancillary | Life Enrichment | Training Institute and Other | Total Program Services | Administrative and Fundraising | Total |
| Salaries | $ 11,109,704 | $ 3,085,108 | $ 2,659,706 | $ 1,411,332 | $ 863,112 | $ 143,036 | $ 19,271,998 | $ 4,299,219 | $ 23,571,217 |
| Percentages | 47.13% | 13.09% | 11.28% | 5.99% | 3.66% | 0.61% | 81.76% | 18.24% | 100.00% |
| Employee Insurance and Payroll Taxes | 1,485,500 | 412,516 | 355,634 | 188,712 | 115,408 | 19,126 | 2,576,895 | 574,857 | 3,151,752 |
| Retirement Benefits | 61,193 | 16,993 | 14,650 | 7,774 | 4,754 | 788 | 106,151 | 23,680 | 129,831 |
| Total Salaries, Insurance, Payroll Taxes, and Benefits | 12,656,396 | 3,514,616 | 3,029,990 | 1,607,818 | 983,274 | 162,949 | 21,955,044 | 4,897,756 | 26,852,800 |
| Bank Fees | - | - | - | - | - | - | - | 1,200 | 1,200 |
| Bad Debt Expense | - | - | - | - | - | - | - | 616,419 | 616,419 |
| Development | - | - | - | - | - | - | - | 586,875 | 586,875 |
| Drugs | - | - | - | 3,000,952 | - | - | 3,000,952 | - | 3,000,952 |
| Dues and Subscriptions | - | - | - | - | - | 65 | 65 | 63,625 | 63,690 |
| Food | - | 2,140,690 | - | - | - | - | 2,140,690 | - | 2,140,690 |
| Insurance | - | - | - | - | - | 18,712 | 18,712 | 434,372 | 453,084 |
| Licenses | 1,877 | - | 21,956 | - | - | - | 23,833 | 13,284 | 37,117 |
| Medical Expenses | - | - | - | 441,029 | - | - | 441,029 | - | 441,029 |
| mmCare. LLC | 146,661 | - | 16,500 | 314,998 | 125 | - | 478,284 | 546,322 | 1,024,606 |
| Other | - | - | - | 11,409 | - | 77 | 11,486 | 623,413 | 634,899 |
| Plant Operation and Maintenance | 26,574 | - | 624,652 | 72,982 | - | - | 724,208 | - | 724,208 |
| Postage | - | - | - | 38,897 | - | - | 38,897 | 23,758 | 62,655 |
| Professional Fees and Contract Services | 1,116,091 | 40,563 | 243,809 | 1,309,289 | 12,555 | 107,999 | 2,830,306 | 1,173,138 | 4,003,444 |
| Security | - | - | 32,527 | - | - | - | 32,527 | - | 32,527 |
| Staff Development | - | - | - | - | - | 26,665 | 26,665 | 165,474 | 192,139 |
| Supplies | 787,527 | 417,412 | 633,743 | 59,025 | 246,394 | 7,139 | 2,151,240 | 130,502 | 2,281,742 |
| Strategic Planning | - | - | - | - | - | - | - | 2,995 | 2,995 |
| Telephone | - | - | - | - | - | 1,243 | 1,243 | 79,684 | 80,927 |
| Travel | - | - | - | - | - | 2,366 | 2,366 | 52,274 | 54,640 |
| Utilities | - | - | 2,508,567 | - | - | - | 2,508,567 | - | 2,508,567 |
| Vehicle and Transportation | - | - | 51,950 | - | - | - | 51,950 | - | 51,950 |
| Total Other Expenses | 2,078,730 | 2,598,665 | 4,133,704 | 5,248,581 | 259,074 | 164,266 | 14,483,020 | 4,513,335 | 18,996,355 |
| Sub-Total | 14,735,126 | 6,113,281 | 7,163,694 | 6,856,399 | 1,242,348 | 327,215 | 36,438,064 | 9,411,091 | 45,849,155 |
| Depreciation | 2,479,329 | 688,497 | 593,561 | 314,964 | 192,619 | 31,921 | 4,300,891 | 961,010 | 5,261,901 |
| Interest | 1,780,287 | 494,377 | 426,208 | 226,160 | 138,310 | 22,921 | 3,088,263 | 689,512 | 3,777,775 |
| Total Year Ended December 31, 2017 | $ 18,994,742 | $ 7,296,155 | $ 8,183,463 | $ 7,397,523 | $ 1,573,278 | $ 382,057 | $ 43,827,217 | $ 11,061,614 | $ 54,888,831 |

*See accompanying Notes to Consolidated Financial Statements.*

# MORNINGSIDE MINISTRIES AND SUBSIDIARIES
# CONSOLIDATED STATEMENTS OF CASH FLOWS
## YEARS ENDED DECEMBER 31, 2018 AND 2017

| | 2018 | 2017 |
|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | |
| Decrease in Net Assets | $ (14,129,166) | $ (1,148,391) |
| Adjustments to Reconcile Decrease in Net Assets to Net Cash Provided (Used) by Operating Activities: | | |
| Depreciation | 5,284,477 | 5,261,901 |
| Amortization of Debt Issuance Costs | 180,336 | 179,836 |
| Amortization of Advance Entrance Fees | (487,839) | (438,855) |
| Unrealized (Gains) Losses on Investments and Assets Limited as to Use | 6,268,451 | (1,175,338) |
| Realized Gains on Investments and Assets Limited as to Use | (3,965,816) | (3,570,414) |
| Loss (Gain) on Sale of Property and Equipment | (38,197) | 34,179 |
| Bad Debt Provision | 390,000 | 616,419 |
| Investment Income (Net of Fees) | (1,088,605) | (793,596) |
| Receipt of Restricted Contributions | (487,244) | (466,977) |
| (Increase) Decrease in Assets: | | |
| Resident Accounts Receivable, Net | 1,148,680 | (784,557) |
| Accounts Receivable - Other | (6,705) | 40,371 |
| Supplies | 19,946 | 46,253 |
| Prepaid Expenses and Deposits | 150,671 | (146,428) |
| Other Assets | (1,750) | 33,628 |
| Increase (Decrease) in Liabilities: | | |
| Accounts Payable | (125,500) | 49,874 |
| Accrued Wages and Related Costs | (247,550) | (111,221) |
| Accrued Insurance Cost | 15,383 | 748 |
| Accrued Expenses | 22,650 | 13,962 |
| Resident Deposits | (32,659) | (8,286) |
| Entrance Fee Turnover, Net | 2,811,694 | 890,298 |
| Net Cash Used by Operating Activities | (4,318,743) | (1,476,594) |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | |
| Purchase of Property, Plant, and Equipment | (2,227,235) | (1,320,943) |
| Sale of Investments and Assets Limited as to Use | 4,668,379 | 21,590,893 |
| Purchase of Investments and Assets Limited as to Use | (150,497) | (21,819,383) |
| Interest and Dividends on Investments and Assets Limited as to Use | 1,088,605 | 793,596 |
| Net Cash Provided (Used) by Investing Activities | 3,379,252 | (755,837) |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | |
| Principal Payments on Long-Term Debt | (1,072,557) | (991,179) |
| Receipt of Restricted Contributions | 487,244 | 466,977 |
| Payment of Debt Issuance Costs | (6,000) | (5,500) |
| Receipt of Initial Entrance Fees | - | 3,027,100 |
| Net Cash Provided (Used) by Financing Activities | (591,313) | 2,497,398 |
| **NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS** | (1,530,804) | 264,967 |
| Cash and Cash Equivalents - Beginning of Year | 11,700,430 | 11,435,463 |
| **CASH AND CASH EQUIVALENTS - END OF YEAR** | $ 10,169,626 | $ 11,700,430 |

*See accompanying Notes to Consolidated Financial Statements.*

**MORNINGSIDE MINISTRIES AND SUBSIDIARIES**
**CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)**
**YEARS ENDED DECEMBER 31, 2018 AND 2017**

| | 2018 | 2017 |
|---|---|---|
| **RECONCILIATION OF CASH AND CASH EQUIVALENTS TO CONSOLIDATED BALANCE SHEET** | | |
| Cash and Cash Equivalents | $ 8,074,417 | $ 9,651,459 |
| Cash and Cash Equivalents - Trustee Held | 2,095,209 | 2,048,971 |
| Cash and Cash Equivalents - End of Year | $ 10,169,626 | $ 11,700,430 |
| **SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION** | | |
| Cash Paid for Interest | $ 3,880,660 | $ 3,612,960 |
| Total Cash Paid for Interest Expense | $ 3,880,660 | $ 3,612,960 |

*See accompanying Notes to Consolidated Financial Statements.*

## NOTE 1 ORGANIZATION AND NATURE OF ACTIVITIES

### Organization

Morningside Ministries (the Organization), is a nonprofit organization that has provided long-term health care services for over 50 years in San Antonio, Texas and the surrounding area. The Organization is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code (IRC). The Organization's facilities provide retirement living, assisted-living, intermediate nursing care, skilled nursing care and rehabilitation.

Established in 1961 by the Rio Texas Conference of the United Methodist Church and five years later joined by Episcopal Diocese of West Texas and First Presbyterian Church of San Antonio, the Organization was founded with the specific mission of caring for older adults. The Organization currently has two distinct retirement communities in San Antonio and Boerne, Texas, including Morningside Ministries at the Meadows, and Morningside Ministries at Menger Springs as follows.

Morningside Ministries at The Meadows offers 142 independent living units, 64 assisted living units and 170 skilled nursing facility and rehabilitation units at the following:

- The Meadows Cottages
- The Meadows Atrium Apartments
- Kaulbach Assisted Living
- Morningside Manor Health Care

Morningside Ministries at Menger Springs offers 200 independent living units, 48 assisted living units, 42 memory care units and 40 skilled nursing facility, wellness and rehabilitation units:

- Menger House Retirement Apartments
- Cibolo House Assisted Living and Memory Care
- Kendall House Wellness and Rehabilitation
- The Cottages Under the Oaks
- The Overlook

The Organization previously operated Morningside Ministries at The Chandler Estate, a retirement community in San Antonio. Morningside Ministries at The Chandler Estate offered 38 independent living units, 24 assisted living units and 113 skilled nursing facility and rehabilitation units. On November 21, 2017, the board of directors of the Organization voted to close The Chandler Estate, effective March 1, 2018.

Training Institutes include:

- Elizabeth McGowen Training Institute at Morningside Ministries (mmLearn.org)

The Organization previously operated the Morningside Ministries Pharmacy. During 2018, the Organization began outsourcing the Pharmacy operations from an unrelated third-party.

## NOTE 1 ORGANIZATION AND NATURE OF ACTIVITIES (CONTINUED)

### Organization (Continued)

The Morningside Ministries Foundation, Inc. (the Foundation) was formed in 1999 to operate for the benefit of the Organization and to support its programs and services. The Foundation began operations on March 31, 2001, when land, land improvements, buildings, temporarily restricted investments, and endowment investments of the Organization were transferred or conveyed to the Foundation. The board of directors of the Foundation consisted of a limited number of representatives from the Organization, one of which was the President of the Organization, and the remaining directors were selected from a board cross-section of the community. Effective January 1, 2017, the Foundation merged with Morningside Ministries.

mmCare, LLC (mmCare) is a Texas Limited Liability Company formed in December 2016 to provide home health services to the community. The Organization is the 75% member as of December 31, 2018. An unrelated party is the 25% member and their activity is recorded as a noncontrolling interest on the consolidated balance sheet. The income or loss of mmCare is shared based the member's respective ownership interests.

## NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Principles of Consolidation

The accompanying consolidated financial statements have been prepared in accordance with generally accepted accounting principles. The consolidated financial statements include the net assets and operations of the Organization, the Foundation, and mmCare, collectively known as the Corporation. Any inter-organization balances and transactions have been eliminated upon consolidation.

### Basis of Accounting

The consolidated financial statements of the Corporation have been prepared on the accrual basis of accounting in accordance with accounting standards generally accepted in the United States of America.

### Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and other support and expenses during the reporting period. Actual results could differ from those estimates.

## NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### Basis of Presentation

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

Net Assets Without Donor Restrictions – Include net assets available for use in general operations and not subject to donor (or certain grantor) restrictions. At times, the governing board can designate, from net assets without donor restrictions, net assets for a board-designated endowment. At December 31, 2018 and 2017, the governing board has not made this designation.

Net Assets With Donor Restrictions – Include net assets subject to donor-imposed restrictions. Some donor-imposed restrictions are temporary in nature, such as those that will be met by the passage of time or other events specified by the donor. Other donor-imposed restrictions are perpetual in nature, where the donor stipulates that resources be maintained in perpetuity. At December 31, 2018 and 2017, donor-imposed restrictions were perpetual in nature of $12,295,422 and $11,977,647, respectively. Donor-imposed restrictions are released when a restriction expires, that is, when the stipulated time has elapsed, when the stipulated purpose for which the resource has been fulfilled, or both.

Unconditional promises to give cash and other assets are accrued at estimated fair market value at the date each promise is received. Management reports contributions restricted by donors as increases in net assets without donor restrictions if the restrictions expire in the reporting period in which the revenue is recognized. All other donor-restricted contributions are reported as increases in net assets with donor restrictions, depending on the nature of the restrictions. When a restriction expires, net assets with donor restrictions are reclassified to net assets without donor restrictions and reported as an increase in net assets without donor restrictions. Income earned on net assets with donor restrictions, including capital appreciation, is recognized in the period earned.

At December 31, 2018 and 2017, the Corporation had net assets with donor restrictions of $15,993,510 and $19,285,297, respectively. The funds are restricted for perpetual endowments to be maintained in perpetuity, for the purpose of various projects, scholarships and staff education.

### Performance Indicator

The consolidated statements of operations include deficit of revenues over expenses, known as the performance indicator. Amounts which are excluded from the performance indicator, consistent with industry practice, include unrealized gains and losses on investments other than trading securities, permanent transfers of assets to and from affiliates for other than goods and services, and contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets).

## NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### Cash and Cash Equivalents

For purposes of the consolidated statement of cash flows, the Corporation considers all treasury bills and certificates of deposit with an original maturity of three months or less to be cash and cash equivalents including trustee held.

### Concentration of Credit Risk

The Corporation holds financial instruments, including cash and a variety of investment funds. Financial instruments are exposed to various risks such as interest rate, credit, and overall market volatility. Due to the level of risk associated with certain investments, it is reasonably possible that changes in the values of the instruments will occur in the near term and that such changes could materially affect account balances and the combined statements of operations. The Corporation believes it places its cash and cash equivalents, restricted cash, and temporary cash investments with high quality credit institutions. At times such investments may be in excess of the Federal Deposit Insurance Corporation insured limit.

The Corporation grants credit without collateral to its residents or their families, most of whom are local residents and who are insured under third-party payor agreements. The amounts due under the Medicare and Medicaid programs as a percentage of total resident accounts receivable were as follows at December 31:

| | 2018 | 2017 |
|---|---|---|
| Medicare | 27% | 17% |
| Medicaid | 22% | 26% |

### Resident Accounts Receivable

The Corporation provides an allowance for uncollectible accounts based on the allowance method using management's judgment. Residents participate in a financial verification process before moving into the Organization, however, residents are not required to provide collateral for services rendered. As a result, 100% collection is not always guaranteed. Payment for services is required within 30 days of receipt of invoice or claim submitted. Accounts past due more than 180 days are individually analyzed for collectability. In addition, an allowance is estimated for other accounts based on the historical experience of the Corporation. When all collection efforts have been exhausted, the account is written off. At December 31, 2018 and 2017, the allowance was approximately $100,000 and $400,000, respectively.

### Supplies

Inventories of supplies are stated at the lower of cost or net realizable value.

## NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### Investments and Assets Limited as to Use

Investments and assets limited as to use include funds held by bond trustees under indenture agreements, designated deposits for entrance fees, pooled investment funds, and assets held for endowments. The investments and assets limited as to use are primarily invested in money market funds, bonds, common stock and mutual funds, which are carried at fair value on the consolidated balance sheets. Amounts required to meet current liabilities of the Corporation are included in current assets.

### Investment Income, Gains, and Losses

Investments are recorded at fair value. Investment return includes interest, dividends, and realized and unrealized gains and losses, less external and direct internal investment expenses. Investment return is reported in the statements of changes in net assets as an increase in net assets without donor restrictions, unless the use of the income is limited by donor-imposed restrictions. Investment return, whose use is restricted by the donor, is reported as an increase in net assets with donor restrictions.

### Home Health License

The Organization assigned a value to the home health license acquired during the year ended December 31, 2016. The Organization performs an annual impairment test of the home health license. As of December 31, 2018 and 2017, management has determined that no impairment exists.

### Property, Plant, and Equipment

Property, plant and equipment are recorded at cost for purchased assets or fair market value at date of receipt for donated assets. Acquisitions or property, plant and equipment in excess of $1,500 and all expenditures for maintenance, repairs, renewals, and betterments that materially extend the useful life of the asset are capitalized. Depreciation is computed using the straight-line method over the estimated useful lives of the assets as follows:

| | |
|---|---|
| Land Improvements | 20 Years |
| Buildings | 20 to 40 Years |
| Equipment and Furniture | 5 to 20 Years |
| Vehicles | 5 to 7 Years |

Construction in progress costs are deferred until the projects are completed and placed into service at which time these costs are depreciated over the useful life of the asset. If any of the projects are cancelled, the costs incurred will be expensed in the year determined.

## NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### Impairment of Long-Lived Assets

On an ongoing basis, the Corporation reviews its long-lived assets, such as property, plant and equipment, and purchased intangible assets subject to amortization, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If circumstances require a long-lived asset be tested for possible impairment, the Corporation would first compare undiscounted cash flows expected to be generated by an asset to the carrying value of the asset. If the carrying value of the long-lived asset is not recoverable on an undiscounted cash flow basis, impairment is recognized to the extent that the carrying value exceeds its fair value. Fair value is determined through various valuation techniques including discounted cash flow models, quoted market values and third-party independent appraisals, as considered necessary. Management did not identify any impairment charges required to be recorded in the accompanying consolidated financial statements related to long-lived assets as of December 31, 2018 and 2017.

### Asset Retirement Obligations

Asset retirement obligations represent obligations to dispose of assets that are legally required to be removed at a future date. Such an obligation would involve the removal of asbestos, if any, in the Corporation’s operating facilities. Based upon the Corporation’s past experience, the costs and the potential liability for such removals are not deemed material and are addressed on a case-by-case basis as operating facilities are renovated. Accordingly, an asset retirement obligation has not been recognized as of December 31, 2018 and 2017.

### Debt Issuance Costs

Costs incurred in connection with the issuance of long-term debt are reported as a reduction to long-term debt and amortized over the term of the debt using the straight-line method, which approximates the effective interest method. At December 31, 2018 and 2017, debt issuance costs were $3,089,050 and $3,088,550, respectively. At December 31, 2018 and 2017, accumulated amortization of debt issuance costs was $863,417 and $688,581, respectively. Interest expense related to the debt issuance costs for the years ended December 31, 2018 and 2017 was $180,336 and $179,836, respectively.

### Accrued Insurance Costs

The Corporation has purchased insurance through September 1, 2016 to cover all workers’ compensation claims above the policy deductible amount. After September 1, 2016, the Corporation entered into a nonsubscriber policy.

The Corporation has purchased insurance to cover professional and general liability insurance claims. The policy limit is $1,000,000 for each claim, with a $3,000,000 aggregate liability limit. Prior to June 1, 2015, the deductible was $50,000 per claim. After this date, including as of December 31, 2018, there is no deductible.

## NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### Deferred Entrance Fees

Contract arrangements for The Cottages Under the Oaks and The Overlook at Menger Springs require certain payments upon occupancy. Entrance fees paid by a resident upon entering into a residence and care agreement, net of the portion thereof that is refundable to the resident, are recorded as deferred revenue and amortized to income using the straight-line method over the estimated remaining life expectancy of the resident, or the contract term, if shorter. The period of amortization for nonrefundable entrance fees is based on the actuarially determined, estimated remaining life expectancy of the resident. Unamortized deferred revenue from entrance fees is recorded as revenue upon a resident's death or contract termination.

The refundable portion of the entrance fee is recorded as a liability as it is generally contingent upon the reoccupancy of the dwelling by a subsequent resident but the refund is not limited to the proceeds of reoccupancy. The amounts received for entrance fees are generally recorded and included in cash and cash equivalents. Contractual refund obligations under the residency agreements was approximately $29,592,000 and $27,507,000 for the years ended December 31, 2018 and 2017, respectively.

### Revenue Recognition

Resident service revenue is reported at the amount that reflects the consideration to which the Corporation expects to be entitled in exchange for providing resident care. These amounts are due from residents, third-party payors (including health insurers and government programs), and others and includes variable consideration for retroactive revenue adjustments due to settlement of audits, reviews, and investigations. Generally, the Corporation bills the residents and third-party payors several days after the services are performed. Revenue is recognized as performance obligations are satisfied.

Performance obligations are determined based on the nature of the services provided by the Corporation. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected (or actual) charges. The Corporation believes that this method provides a faithful depiction of the transfer of services over the term of the performance obligation based on the inputs needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to residents in the facility receiving skilled nursing services or housing residents receiving services in the facility. The Corporation considers daily services provided to residents of the skilled nursing facility, and monthly rental for housing services as a separate performance obligation and measures this on a monthly basis, or upon move-out within the month, whichever is shorter. Nonrefundable entrance fees are considered to contain a material right associated with access to future services, which is the related performance obligation. Revenue from nonrefundable entrance fees is recognized ratably in future periods covering a resident's life expectancy using a time-based measurement similar to the output method. Revenue for performance obligations satisfied at a point in time is generally recognized when goods are provided to the residents and customers in a retail setting (for example, gift shop and cafeteria meals) and the Corporation does not believe it is required to provide additional goods or services related to that sale.

## NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### Revenue Recognition (Continued)

The Corporation determines the transaction price based on standard charges for goods and services provided, reduced by contractual adjustments provided to third-party payors, discounts provided to uninsured patients in accordance with the Corporation’s policy and/or implicit price concessions provided to residents. The Corporation determines its estimates of contractual adjustments based on contractual agreements, its policies, and historical experience. The Corporation determines its estimate of implicit price concessions based on its historical collection experience.

Agreements with third-party payors typically provide for payments at amounts less than established charges. A summary of the payment arrangements with major third-party payors follows:

#### Medicaid

The Corporation participates in the Medicaid program that is administered by the Texas Health and Human Services Commission. Skilled nursing centers that participate in the Medicaid program in the state of Texas are reimbursed based upon prospective rates. The Corporation is required to file an annual Medicaid cost report which is subject to audit by the Texas Health and Human Services Commission. Adjustments to the report may prospectively affect payment rates.

#### Medicare

The licensed nursing facilities participate in the Medicare program. This federal program is administered by the Centers for Medicare and Medicaid Services (CMS). The nursing facilities are paid under the Medicare Prospective Payment System (PPS) for residents who are Medicare Part A eligible and meet the coverage guidelines for skilled nursing facility services. The PPS is a per diem price-based system. Annual cost reports are required to be submitted to the designated Medicare Administrative Contractor; however, they do not contain a cost settlement.

Nursing facilities licensed for participation in the Medicare and Medical Assistance programs are subject to annual licensure renewal. If it is determined that a nursing facility is not in substantial compliance with the requirements of participation, CMS may impose sanctions and penalties during the period of noncompliance. Such a payment ban would have a negative impact on the revenues of the licensed nursing facility.

#### Other

Payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations provide for payment using prospectively determined daily rates.

## NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### Revenue Recognition (Continued)

Settlements with third-party payors for retroactive adjustments due to audits, reviews, or investigations are considered variable consideration and are included in the determination of the estimated transaction price for providing patient care. These settlements are estimated based on the terms of the payment agreement with the payor, correspondence from the payor and the Corporation's historical settlement activity, including an assessment to ensure that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the retroactive adjustment is subsequently resolved. Estimated settlement are adjusted in future periods as adjustments become known (that is, new information becomes available), or as years are settled or are no longer subject to such audits, reviews, and investigations. Adjustments arising from a chance in an implicit price concession impacting transaction price, were not significant in 2018 or 2017.

Generally residents who are covered by third-party payors are responsible for related deductibles and coinsurance, which vary in amount. The Corporation estimates the transaction price for residents with deductibles and coinsurance based on historical experience and current market conditions. The initial estimate of the transaction price is determined by reducing the standard charge by any contractual adjustments, discounts, and implicit price concessions. Subsequent charges to the estimate of the transaction price are generally recorded as adjustments to resident services revenue in the period of the change. Additionally revenue recognized due to changes in its estimates of implicit price concessions, discounts, and contractual adjustments were not considered material for the years ended December 31, 2018. Subsequent changes that are determined to be the result of an adverse change in the resident's ability to pay are recorded as bad debt expense.

The Corporation has determined that the nature, amount, timing, and uncertainty of revenue and cash flows are affected by the following factors:

- Payors (for example, Medicare, Medicaid, managed care or other insurance, resident) have different reimbursement/payment methodologies
- Length of the resident's service/episode of care
- Geography of the service location
- Method of reimbursement (fee for service or capitation)
- The Corporation's line of business that provided the service (skilled nursing, assisted living, independent living, home health, etc.)

For the years ended December 31, 2018 and 2017, the Corporation recognized revenue of approximately $24,389,000 and $30,057,000, respectively, from goods and services that transfer to the customer over time and $487,839 and $438,855, respectively from goods and services that transfer to the customer at a point in time.

## NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### Supplemental Payment Program

Texas Health and Human Services Commission (THHSC) implemented a Quality Incentive Payment Program (QIPP) that became effective April 1, 2017 for nonstate government-owned nursing facilities. Participation in these programs is voluntary. This program allows states to claim federal matching funds under Medicaid up to what Medicare would pay for a similar service. As of April 1, 2017, the Organization participated in this program (See Note 6).

### Nonoperating Revenue

Unrestricted gifts, bequests, and investments earnings are included as nonoperating revenue.

### Income Taxes

The Organization and the Foundation are nonprofit organizations classified as public charities and have been granted exempt status under Section 501(c)(3) of the IRC and applicable state codes.

The Organization and the Foundation's income tax returns are subject to review and examination by federal authorities. The Organization and the Foundation are not aware of any activities that would jeopardize their tax-exempt status. The Organization and the Foundation is not aware of any activities that are subject to tax on unrelated business income or excise or other tax except for those that are already reported annually.

mmCare is a limited liability company and is not subject to income tax. Therefore, taxable income or loss is reported to the individual members for inclusion in their respective tax returns and no provision for federal and state income taxes has been recorded in the accompanying consolidated financial statements.

The accounting standard on accounting for uncertainty in income taxes addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the consolidated financial statements. Under that guidance, the Corporation may recognize the tax benefit from an uncertain tax position only if it is more likely than not, that the tax position will be sustained on examination by taxing authorities based on the technical merits of the position. Examples of tax positions include the tax-exempt status of the Organization and the Foundation and various positions related to the potential sources of unrelated business taxable income (UBIT). The tax benefits recognized in the consolidated financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. Management believes there are no unrecognized tax benefits identified or recorded as liabilities for the years ended December 31, 2018 and 2017.

### Commitments and Contingencies

Liabilities for loss contingencies arising from claims, assessments, litigation, fines, penalties, and other sources are recorded when it is probable that a liability has been incurred and the amount can be reasonably estimated.

## NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### Donated Assets and Services

Donated marketable securities and other noncash donations are recorded at their estimated fair values at the date of donation. Generally no amounts are reflected in the consolidated financial statements for donated services. The Corporation generally pays for services requiring specific expertise. However, many individuals volunteer their time and perform various tasks to assist the residents of the Corporation's facilities. The Corporation receives more than 20,000 volunteer hours per year.

### Functional Allocation of Expenses

The statement of functional expenses presents the natural classification detail of expenses by function. Accordingly, certain costs have been allocated among the programs and supporting services benefited utilizing units of service and department allocations.

### New Accounting Pronouncements – ASU 2014-09

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers*. ASU 2014-09's core principle is that an organization will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the organization expects to be entitled in exchange for those goods or services. During the year ended December 31, 2018, the Corporation early adopted ASU 2014-09.

ASU 2014-09 requires organizations to exercise more judgment and recognize revenue using a five-step process. The Corporation adopted ASU 2014-09 using the modified retrospective method for all contracts effective January 1, 2018 and is using a portfolio approach to group contracts with similar characteristics and analyze historical cash collections trends. Modified retrospective adoption requires entities to apply the standard retrospectively to the most current period presented in the financial statements. The adoption of this accounting standard did not have an impact on the Corporation's financial position, changes in its net assets, or any line items presented in the 2017 financial statements, had the full retrospective method been adopted.

### New Accounting Pronouncements – ASU 2016-14

During the year ended December 31, 2018, the Corporation adopted a provision of Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) 2016-14, *Presentation of Financial Statements for Not-For-Profit Entities*. This new accounting standard results in a reduction of three classes of net assets (unrestricted, temporarily restricted, and permanently restricted) to two (net assets with donor restrictions and net assets without donor restrictions) and includes enhanced financial statement disclosures. The adoption of this accounting standard did not have an impact on the Corporation's financial position or changes in its net assets.

### Reclassifications

Certain items in the prior year consolidated financial statements have been reclassified to conform with the current year basis of presentation.

## NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

**Subsequent Events**

In preparing these consolidated financial statements, the Corporation has evaluated events and transactions for potential recognition and disclosure through April 16, 2019, the date the consolidated financial statements were available to be issued.

## NOTE 3 LIQUIDITY AND AVAILABILITY OF CASH

Financial assets available for general expenditure, that is, without donor or other restrictions limiting their use, within one year of the balance sheet date, comprise the following:

| | 2018 | 2017 |
|---|---|---|
| Cash and Cash Equivalents | $ 8,074,417 | $ 9,651,459 |
| Resident Accounts Receivable, Net | 1,737,218 | 3,275,898 |
| Current Portion of Assets Limited As to Use | 2,095,208 | 2,041,187 |
| Investments | 20,430,725 | 23,959,454 |
| Accrued Interest Receivable | - | 20,786 |
| Total Assets Available for General Expenditure | $ 32,337,568 | $ 38,948,784 |

The Corporation has other assets limited as to use held by bond trustee and held for assets with donor restrictions. These assets limited as to use, which are more fully described in Note 4, are not available for general expenditure within the next year and are not reflected in the amounts above.

As part of the Corporation's liquidity management plan, they invest cash in excess of daily requirements in short-term investments and money market accounts.

## NOTE 4 INVESTMENTS AND ASSETS LIMITED AS TO USE

**Trustee Held Funds**

The Corporation is required to hold funds in various accounts based upon terms in the indenture of trust of the Series 2013 bond issuances. These funds consist of the following:

Principal Account

Bond principal account has been established to service the required principal payments to bondholders.

Interest Account

Bond interest account has been established to service the required interest payments to bondholders.

Reserve Fund

The reserve fund has been established to provide a reserve for payment of principal and interest on the bonds in the event the Corporation's principal and interest payments are insufficient to meet debt service requirements.

## NOTE 4 INVESTMENTS AND ASSETS LIMITED AS TO USE (CONTINUED)

The assets limited as to use are included as follows on the consolidated balance sheets at December 31:

| | 2018 | 2017 |
|---|---|---|
| **TRUSTEE HELD FUNDS** | | |
| Principal Account | $ 553,119 | $ 535,598 |
| Interest Account | 1,542,090 | 1,513,373 |
| Total Trustee Held Funds | 2,095,209 | 2,048,971 |
| **DEBT SERVICE RESERVE FUND** | 3,548,238 | 3,548,238 |
| **ENDOWMENT, PURPOSE, AND TIME RESTRICTED INVESTMENTS** | | |
| Accrued Interest Receivable | - | 20,786 |
| Annuity Gifts Receivable | 8,938 | 8,829 |
| Beneficial Interest - Trusts | 2,644,352 | 8,050,670 |
| Cash and Cash Equivalents | 426,802 | 2,084,986 |
| Land and Property, Plant, and Equipment, Net | 2,974 | 2,974 |
| Pledge Receivables | 81,503 | 130,763 |
| Pooled Investment Funds | 12,842,119 | 11,842,232 |
| Due to Investments | (13,180) | (2,855,944) |
| Total Endowment, Purpose, and Time Restricted Investments | 15,993,508 | 19,285,296 |
| Total Assets Limited as to Use | 21,636,955 | 24,882,505 |
| Less: Current Portion of Assets Limited as to Use | (2,095,208) | (2,041,187) |
| Assets Limited as to Use, Net of Current Portion | $ 19,541,747 | $ 22,841,318 |

The investments are undesignated and are included as follows on the consolidated balance sheets at December 31:

| | 2018 | 2017 |
|---|---|---|
| **INVESTMENTS** | | |
| Cash and Cash Equivalents | $ 833 | $ 1,601,933 |
| Pooled Investment Funds | 20,416,712 | 19,501,577 |
| Due from Endowment, Purpose, and Time Restricted | 13,180 | 2,855,944 |
| Total Investments | $ 20,430,725 | $ 23,959,454 |

## NOTE 4 INVESTMENTS AND ASSETS LIMITED AS TO USE (CONTINUED)

Investment and assets limited as to use are invested in the following at December 31:

| | December 31, 2018 | |
|---|---|---|
| | Fair Value | Cost |
| Cash and Cash Equivalents | $ 6,135,265 | $ 6,135,265 |
| Money Markets | 23,455 | 22,873 |
| Bonds | 10,970,010 | 11,056,756 |
| Common Stock | 22,491,389 | 25,376,228 |
| Mutual Funds | 100,327 | 100,327 |
| Beneficial Interest in Perpetual Trust | 2,347,234 | 2,347,234 |
| Total Investments and Assets Limited as to Use | $ 42,067,680 | $ 45,038,683 |

| | December 31, 2017 | |
|---|---|---|
| | Fair Value | Cost |
| Cash and Cash Equivalents | $ 6,523,048 | $ 6,523,048 |
| Money Markets | 2,924,432 | 2,924,432 |
| Bonds | 9,305,955 | 9,406,347 |
| Common Stock | 25,068,928 | 21,529,337 |
| Mutual Funds | 2,512,259 | 2,434,046 |
| Beneficial Interest in Perpetual Trust | 2,507,337 | 2,507,337 |
| Total Investments and Assets Limited as to Use | $ 48,841,959 | $ 45,324,547 |

The accumulated investment earnings of perpetual endowment funds and purpose restricted investments, along with amounts of which the donor restriction has been fulfilled, are available for undesignated use and are reflected above as due to board-designated funds. Absent donor restrictions, accumulated investment earnings on perpetual endowment funds are classified as time restricted until they are spent and released to undesignated net assets.

Investment income, gains, and losses for assets limited as to use, cash equivalents, and other investments are composed of the following for the years ended December 31:

| | 2018 | 2017 |
|---|---|---|
| Interest and Dividend Income | $ 1,180,398 | $ 1,122,937 |
| Realized Gains on Sales of Securities | 3,965,816 | 3,570,414 |
| Unrealized Gains (Losses) on Marketable Securities | (6,268,451) | 1,175,338 |
| Investment Service Fees | (91,793) | (329,341) |
| Total | $ (1,214,030) | $ 5,539,348 |
| | | |
| Unrestricted Investment Earnings | $ (744,188) | $ 3,540,490 |
| Gain (Loss) on Endowment Investments | (469,842) | 1,998,858 |
| Total | $ (1,214,030) | $ 5,539,348 |

## NOTE 5 BENEFICIAL INTEREST IN TRUSTS

**Split Interest**

The Corporation was a two-fifths income beneficiary of the Maida Davis Turtle Charitable Trust (20% to Morningside Manor and 20% to Chandler Home and Apartments), which was established upon the death of the settlor. Four income beneficiaries are to be distributed a proportionate share of the net income of the trust annually. The trust will terminate the sooner of 50 years after the death of the settlor, or 21 years after the death of the last to die of the beneficiaries named in article III of the trust, at which time, 40% the remaining principal is to be distributed to the Corporation. Effective March 1, 2018, The Chandler Estate closed, which reduced the Corporation's income beneficiary percentage from 40% to 25%. Due to the closure of The Chandler Estate, the corpus portion of the Maida Davis Turtle Charitable Trust related to The Chandler Estate of $175,941 was forfeited in 2018, and is reported in the consolidated statement of changes in net assets as a decrease in net assets with donor restrictions – time restrictions. The fair market value portion of the The Chandler Estate's beneficial interest of $18,591 was written off during 2018 and is reported in the consolidated statement of changes in net assets as a decrease in net assets without donor restrictions. A noncurrent asset for the beneficial interest in the trust has been recognized at fair value, based on quoted market prices, which totals $297,118 and $518,016 at December 31, 2018 and 2017, respectively. For the years ended December 31, 2018 and 2017, the Corporation received $12,828 and $17,362, respectively, in earnings distributions from the Trust.

The Corporation is a 2% income beneficiary of the Leon O. and Mary Jane K. Lewis Charitable fund. The Corporation's beneficial interest in the fund of 155,297 and $82,088 at December 31, 2018 and 2017, respectively, is recorded in endowment assets. For the years ended December 31, 2018 and 2017, the Corporation received $4,477 and $-0-, respectively, in earnings distributions from the Trust.

The Corporation is a one-third income beneficiary of the William C. and Verna Upton Alder Charitable Foundation, an irrevocable perpetual trust. In accordance with the trust agreement, the trustee shall distribute one-third of the trust's net income to the Corporation. The Corporation's beneficial interest in the trust of $1,975,948 and $2,185,488 at December 31, 2018 and 2017, respectively, is recorded in endowment assets. For the years ended December 31, 2018 and 2017, the Corporation received $91,920 and $90,016, respectively, in earnings distributions from the Trust.

The Corporation is a one-fifth income beneficiary of the Sears Benevolent Endowment Fund. The Corporation's beneficial interest in the fund at December 31, 2018 and 2017 is $209,314 and $232,830, respectively, which is recorded in endowment assets. For the years ended December 31, 2018 and 2017, the Corporation received $8,267 and $7,083, respectively, in earnings distributions from the Trust.

## NOTE 5 BENEFICIAL INTEREST IN TRUSTS (CONTINUED)

**Sole Beneficiary**

The Corporation was the sole income beneficiary of the Chandler Memorial Home Trust, an irrevocable trust. In accordance with the Trust agreement, the Trustee shall distribute all Trust net income, exclusive of realized gains and losses, to the Corporation for the benefit of the Chandler campus. The Trustee may also distribute a portion of the Trust corpus and realized gains to the Corporation if such distribution is determined to be reasonable and necessary by the Trustee. In the event the Corporation would no longer operate a residential facility, the Trustee may distribute the income and a reasonable amount of the Trust corpus to another charitable organization. Effective March 1, 2018, The Chandler Estate closed and is no longer the sole beneficiary to the Chandler Memorial Home Trust.

The Corporation's beneficial interest in the Trust of $-0- and $5,025,317 at December 31, 2018 and 2017, respectively, is recorded in endowment and purpose restricted investments section of assets limited as to use on the consolidated financial statements.

The Corporation had previously recognized $2,350,612 as the original corpus in net assets with purpose restrictions. Due to the closure of The Chandler Estate, the beneficial interest in the Chandler Memorial Home Trust was forfeited during 2018, and is reported in the consolidated statement of changes in net assets as a decrease in net assets with donor restrictions – purpose restrictions (See Note 11). The fair market value of the beneficial interest in the Chandler Memorial Home Trust of $2,711,283 was written off during 2018 and is reported in the consolidated statement of changes in net assets as a decrease in net assets without donor restrictions. Accumulated earnings of $-0- and $2,674,705 are reported as a component of undesignated net assets as of December 31, 2018 and 2017, respectively. For the years ended December 31, 2018 and 2017, the Corporation received $-0- and $67,502, respectively, in earnings distributions from the Trust for the benefit of the The Chandler Estate.

## NOTE 6 SUPPLEMENTAL PAYMENT PROGRAM

On April 1, 2017, the Organization participated in the QIPP program (See Note 2) and sold its nursing home license for Morningside Manor Health Care and The Chandler Estate to a nonstate government hospital district (the Hospital Partner) for a nominal amount. In conjunction with the sale, the Organization executed separate lease and management agreements. Under the terms of the lease agreement, the Hospital Partner agrees to lease the Organization's nursing facility space in the amount of $70,833 per month for Morningisde Manor Health Care and $41,667 per month for The Chandler Estate. For the years ending December 31, 2018 and 2017, total lease revenue was $933,333 and $1,012,500, respectively. The lease is set to expire on August 31, 2019; however, the term of the lease shall be extended for successive one year terms unless the Organization or Hospital Partner provide written notice not to renew the lease 35 days prior to the end of the lease term or terminate based on other conditions outlined in the lease agreement. In the event of a termination, the nursing home license will revert back to the Organization to operate the facility.

## NOTE 6 SUPPLEMENTAL PAYMENT PROGRAM (CONTINUED)

Under the terms of the management agreement, the Organization will manage the nursing facility and receive a management fee equal to the total net revenue received in connection with the operation of the nursing home each month. For the years ending December 31, 2018 and 2017, total management fee revenue was $13,593,660 and $15,039,877, respectively. In addition, under the terms of the management agreement, the Organization will receive an incentive payment equal to 50% of the total incentive payment received under the QIPP program. For the years ending December 31, 2018 and 2017, the total incentive fee revenue was $39,432 and $75,900, respectively. The management agreement is set to expire on August 31, 2019; however the management agreement shall automatically renew for one year unless the Organization or Hospital Partner provide written notice 35 days prior to the end of the management agreement or terminate based on other conditions outlined in the management agreement. In the event of termination, the Hospital Partner will transfer the operations of the facility back to the Organization. Finally, in the event that either the management agreement or lease agreement is terminated by the Organization or the Hospital Partner, such termination will result in the simultaneous termination of the other agreement. Effective March 1, 2018, The Chandler Estate closed, which resulted in the automatic termination of both the lease and management agreement with the Hospital.

## NOTE 7 FAIR VALUE MEASUREMENTS

The Corporation categorizes its assets and liabilities measured at fair value into a three level hierarchy based on the priority of the inputs to the valuation technique used to determine fair value. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets and liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). If the inputs used in the determination of the fair value measurement fall within different levels of the hierarchy, the categorization is based on the lowest level input that is significant to the fair value measurement. Assets and liabilities valued at the fair value are categorized based on the inputs to the valuation techniques as follows:

*Level 1* – Inputs that utilize (unadjusted) quoted prices in active markets for identical assets or liabilities that the Corporation has the ability to access.

*Level 2* – Inputs that include quoted prices for similar assets and liabilities in active markets and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument. Fair values for these instruments are estimated using pricing models, quoted prices of securities with similar characteristics, or discounted cash flows.

*Level 3* – Inputs that are unobservable inputs for the asset or liability, which are typically based on an entity's own assumptions, as there is little, if any, related market activity.

## NOTE 7 FAIR VALUE MEASUREMENTS (CONTINUED)

Additionally, from time to time, the Corporation may be required to record at fair value other assets on a nonrecurring basis in accordance with generally accepted accounting principles. These adjustments to fair value usually result from the application of the lower-of-cost-or-market accounting or write down of individual assets. Nonfinancial assets measured at fair value on a nonrecurring basis would include nonfinancial assets and nonfinancial liabilities measured at fair value in the second step of a goodwill impairment test, other real estate owned, and other intangible assets measured at fair value for impairment assessment.

The Corporation also adopted the policy of valuing certain financial instruments at fair value. This accounting policy allows entities the irrevocable option to elect fair value for the initial and subsequent measurement for certain financial assets and liabilities on an instrument-by-instrument basis. The Corporation has not elected to measure any existing financial instruments at fair value, however, may elect to measure newly acquired financial instruments at fair value in the future.

The following tables present the fair value hierarchy for the Corporation measured at fair value on a recurring basis as of December 31:

| | 2018 | | | |
|---|---|---|---|---|
| | Total | Level 1 | Level 2 | Level 3 |
| Assets: | | | | |
| Investments and Assets | | | | |
| Limited as to Use: | | | | |
| Money Markets | $ 23,455 | $ 23,455 | $ - | $ - |
| Bonds | 10,970,010 | 10,970,010 | - | - |
| Common Stock | 22,491,389 | 22,491,389 | - | - |
| Mutual Funds | 100,327 | 100,327 | - | - |
| Beneficial Interest in | | | | |
| Perpetual Trusts | 2,347,234 | - | - | 2,347,234 |
| Total Assets | $ 35,932,415 | $ 33,585,181 | $ - | $ 2,347,234 |

| | 2017 | | | |
|---|---|---|---|---|
| | Total | Level 1 | Level 2 | Level 3 |
| Assets: | | | | |
| Investments and Assets | | | | |
| Limited as to Use: | | | | |
| Money Markets | $ 2,924,432 | $ 2,924,432 | $ - | $ - |
| Bonds | 9,305,954 | 9,305,954 | - | - |
| Common Stock | 25,068,928 | 25,068,928 | - | - |
| Mutual Funds | 2,512,259 | 2,512,259 | - | - |
| Beneficial Interest in | | | | |
| Perpetual Trusts | 2,507,337 | - | - | 2,507,337 |
| Total Assets | $ 42,318,910 | $ 39,811,573 | $ - | $ 2,507,337 |

## NOTE 7 FAIR VALUE MEASUREMENTS (CONTINUED)

The following table presents changes in assets measured at fair value using Level 3 inputs on a recurring basis for the years ended December 31:

| | 2018 | 2017 |
|---|---|---|
| Balance, Beginning of Year | $ 2,507,337 | $ 2,283,189 |
| Contributions | 22 | 16 |
| Income and Expenses, Net | (55,462) | 327,510 |
| Distributions | (104,663) | (103,378) |
| Balance, End of Year | $ 2,347,234 | $ 2,507,337 |

Investments and assets limited as to use are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions, and other factors such as credit loss assumptions. Securities valued using Level 1 inputs include those traded on an active exchange, such as the New York Stock Exchange, as well as U.S. Treasury and other U.S. government and agency mortgage-backed securities that are traded by dealers or brokers in active over-the-counter markets.

Fair value for the contributions receivable from beneficial interests in perpetual trusts are measured using the Corporation's interest in the fair value of the assets held in the trusts as reported by the trustees as of December 31, 2018 and 2017. The Corporation considers the measurement of its beneficial interests in the trusts to be Level 3 measurements within the fair value hierarchy because even though the measurement is based on the unadjusted fair values of the trusts' assets reported by the trustee, the Corporation will never receive those assets or have the ability to direct the trustees to redeem them.

## NOTE 8 PLEDGE RECEIVABLES

Included in pledges receivable are amounts that comprise the following unconditional promises to give and conditional promises to give for which conditions have been substantially met at December 31:

| | 2018 | 2017 |
|---|---|---|
| Receivable in Less than One Year | $ 81,503 | $ 130,763 |
| Total Pledge Receivable | $ 81,503 | $ 130,763 |

Pledges receivable are included in Endowment and Purpose Restricted Investments in the consolidated balance sheets. No allowance for uncollectible pledges or discount has been recorded as all pledges receivable are due in 2019.

## NOTE 9 PROPERTY, PLANT, AND EQUIPMENT

Property, plant, and equipment consist of the following at December 31:

| | 2018 | 2017 |
|---|---|---|
| Land | $ 4,902,534 | $ 4,902,534 |
| Land Improvements | 5,296,872 | 5,242,852 |
| Buildings | 133,919,434 | 133,338,063 |
| Equipment and Furniture | 9,457,611 | 10,114,363 |
| Vehicles | 417,519 | 812,084 |
| Construction in Progress | 606,397 | 202,825 |
| Total | $ 154,600,367 | $ 154,612,721 |

Total depreciation expense for the years ended December 31, 2018 and 2017 was $5,284,477 and $5,261,901, respectively.

**Construction in Progress**

Construction in progress for the years ending December 31, 2018 and 2017 of $606,397 and $202,825, respectively, is related to various renovations and ongoing special projects. These projects are being financed with internal funds.

## NOTE 10 LONG-TERM DEBT

The Corporation's long-term debt is summarized below at December 31:

| | 2018 | 2017 |
|---|---|---|
| New Hope Cultural Revenue Bonds Series 2013 | $ 47,140,000 | $ 47,675,000 |
| New Hope Cultural Revenue Construction Loan 2014 | 28,991,265 | 29,528,822 |
| Subtotal | 76,131,265 | 77,203,822 |
| Unamortized Debt Issuance Costs | (2,225,633) | (2,399,969) |
| Total Long-Term Debt | 73,905,632 | 74,803,853 |
| Less: Current Maturities of Long-Term Debt | (949,855) | (1,282,530) |
| Long-Term Debt, Net | $ 72,955,777 | $ 73,521,323 |

Scheduled principal payments on long-term debt for the next five years and thereafter are as follows:

| Year Ending December 31, | Amount |
|---|---|
| 2019 | $ 949,855 |
| 2020 | 988,068 |
| 2021 | 1,030,488 |
| 2022 | 28,397,853 |
| 2023 | 670,000 |
| Thereafter | 44,095,001 |
| Total | $ 76,131,265 |

## NOTE 10 LONG-TERM DEBT (CONTINUED)

### New Hope Cultural Revenue Bonds Series 2013

On September 19, 2013, the New Hope Cultural Education Facilities Corporation (Issuer) issued First Mortgage Revenue Bonds (Morningside Ministries Project) Series 2013 in the amount of $49,335,000 on behalf of the Organization with the proceeds used to (1) refund all of the outstanding Kendall County Health Facilities Development Corporation Variable Rate Demand Health Care Revenue Bonds (Morningside Ministries Project) Series 2008 and (2) to pay a portion of the cost of issuance of the Series 2013 bonds.

The 2013 bonds are fixed rate bonds with the maturities and pricing as follows:

| Maturity (January 1,) | Principal Amount | Interest Rate |
|---|---|---|
| 2019 | $ 550,000 | 3.25% |
| 2024 | 3,200,000 | 5.00% |
| 2034 | 9,960,000 | 6.25% |
| 2044 | 18,525,000 | 6.50% |
| 2048 | 14,905,000 | 6.50% |
| Total | $ 47,140,000 | |

The Issuer created and ordered established with U.S. Bank National Association (Bond Trustee) a trust fund (Bond Fund). There are two separate accounts within the Bond Fund designated as the Principal Account and the Interest Account, respectively. The Organization will deposit monthly 1/6 of the semi-annual interest payment into the Interest Account, and monthly 1/12 of the annual principal payment into the Principal Account. Additionally, the Issuer established with the Bond Trustee, a Debt Service Reserve Fund to be used to provide a reserve for the payment of principal and interest on the bonds. This Debt Service Reserve Fund was funded at issuance in the amount of $3,548,238, which is equal to the maximum annual debt service on the bonds. Additionally, the Series 2013 bonds are secured by certain bank accounts, property, plant, and equipment.

### Restrictive Covenants

Under the terms of the Series 2013 Bonds, the Organization is required to meet certain restrictive covenants related to the reporting and other financial and nonfinancial covenants. As of December 31, 2018, management was not aware of instances where the Organization was not in compliance with these covenants.

## NOTE 10 LONG-TERM DEBT (CONTINUED)

**New Hope Cultural Revenue Construction Loan 2014**

On March 1, 2014, the Organization was issued a construction loan by BBVA Compass Bank. Advances are made pursuant to the Construction Loan Agreement, and can reach a maximum principal amount of $42,000,000. Repayment of this note shall be in 36 consecutive monthly interest only payments commencing on May 1, 2014. At the end of the interest only period, the loan shall not exceed $30,000,000. After this period, repayment shall be in 59 consecutive monthly principal and interest payments based on a 25-year amortization schedule, with a final payment of all outstanding principal and interest due at maturity on May 1, 2022. Interest on this note is charged at a variable rate based on 65% times the sum of one month LIBOR plus 1.90% (3.49% and 2.25% at December 31, 2018 and 2017, respectively). The construction loan is secured by certain bank accounts, property, plant, and equipment. On August 31, 2016, the Organization made a $12,000,000 principal payment with initial entrance fees from The Overlook.

## NOTE 11 NET ASSETS WITH DONOR RESTRICTIONS

**Net Assets with Purpose Restrictions**

Net assets with purpose restrictions include gifts and contributions, which are restricted by the donors for specific purposes. Once the specific purposes are achieved, the net assets with purpose restrictions are transferred to undesignated net assets. Net assets with purpose restrictions consist of the following at December 31:

| | 2018 | 2017 |
|---|---|---|
| Direct Charity Fund | $ 61,654 | $ 3,698 |
| Manor Unit #5 Renovation Fund | 26,375 | 29,632 |
| Special Projects Fund | 102,182 | 160,140 |
| Loewenberg Scholarship Fund | 107,874 | - |
| Chandler Trust Fund | - | 2,350,612 |
| mmLearn.org Fund | 259,116 | 505,297 |
| Meadows Employee Fund | 8,000 | 8,000 |
| Total Net Assets with Purpose Restrictions | $ 565,201 | $ 3,057,379 |

**Net Assets with Time Restrictions**

Net assets with time restrictions include perpetual endowment fund earnings and charitable trusts, which are restricted by the donors such as those that will be met by the passage of time. Once the passage of time has been met, the net assets with time restrictions are transferred to undesignated net assets. Net assets with time restrictions consist of the following at December 31:

| | 2018 | 2017 |
|---|---|---|
| Perpetual Endowment Funds | $ 12,295,422 | $ 11,977,647 |
| Time Restricted Perpetual Endowment Fund Earnings | 2,839,653 | 3,781,096 |
| Total | $ 15,135,075 | $ 15,758,743 |

## NOTE 11 NET ASSETS WITH DONOR RESTRICTIONS (CONTINUED)

**Perpetual Endowment Funds**

Perpetual endowment funds consist of contributions and gifts given for Covenant assistance and to provide for upkeep of the Meadows facility. The amounts are maintained in perpetuity. Interest and dividends on perpetual endowment funds are used for Covenant assistance.

Perpetual endowment funds consisted of the following at December 31:

| | 2018 | 2017 |
|---|---|---|
| Covenant Fund | $ 7,905,422 | $ 7,587,647 |
| Kaulbach Fund | 3,390,000 | 3,390,000 |
| Meadows improvements | 1,000,000 | 1,000,000 |
| Total | $ 12,295,422 | $ 11,977,647 |

The Corporation has perpetual endowment funds to which donors have permanently restricted their contributions. According to the investment guidelines set forth by the board of directors of the Foundation, 3% of the underlying investment balances are available to be transferred to undesignated funds on an annual basis. Transfers during the years ended December 31, 2018 and 2017 totaled $471,601 and $421,200, respectively.

**Interpretation of Relevant Law**

In July 2006, the Uniform Law Commission approved the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA) as a modernized version of the Uniform Management of Institutional Funds Act of 1972, the model act governing the investment and management of donor restricted endowment funds by nonprofit organizations. Among its changes, UPMIFA prescribes guidelines for expenditure of a donor-restricted endowment funds, including Subsection 4(a) which states, "unless stated otherwise in the gift instrument, the assets in an endowment fund are donor restricted assets until appropriated for expenditure by the institution". The effective date of this new law began for fiscal years ending after December 15, 2008. As a result, certain amounts previously recorded in unrestricted net assets were reclassified to comply with the law.

## NOTE 11 NET ASSETS WITH DONOR RESTRICTIONS (CONTINUED)

**Interpretation of Relevant Law (Continued)**

Management has interpreted the State Prudent Management of Institutional Funds Act (SPMIFA) has required the preservation of 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, the Corporation reclassifies as perpetual endowment funds (a) the original value of gifts donated to the perpetual endowment, (b) the original value of subsequent gifts to the perpetual endowment, and (c) accumulations to the perpetual 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 perpetual endowment funds is classified as either purpose restricted or time restricted net assets until those amounts are appropriated for expenditure by the Corporation in a manner consistent with the standard of prudence prescribed by SPMIFA. In accordance with SPMIFA, the Corporation considers the following in making a determination to appropriate or accumulate donor-restricted endowment funds:

- The duration and preservation of the fund
- The purposes of the organization and the donor-restricted endowment fund
- General economic conditions
- The possible effect of inflation and deflation
- The expected total return from income and the appreciation of investments
- Other resources of the Corporation
- The investment policies of the Corporation

The donor-restricted endowment fund composition by type is comprised of the following at December 31:

| | 2018 | 2017 |
|---|---|---|
| Perpetual Endowment Funds | $ 12,295,422 | $ 11,977,647 |
| Time Restricted Perpetual Endowment Fund Earnings | 2,839,653 | 3,781,096 |
| Total | $ 15,135,075 | $ 15,758,743 |

The Corporation had the following changes in time restricted endowment funds earnings during the years ended December 31:

| | 2018 | 2017 |
|---|---|---|
| Investment Return: | | |
| Investment Income | $ 478,029 | $ 279,641 |
| Net Appreciation (Depreciation) | (903,357) | 1,839,930 |
| Amounts Appropriated for Expenditures | (471,601) | (421,200) |
| Investment Fees | (44,514) | (120,713) |
| Total | $ (941,443) | $ 1,577,658 |

## NOTE 11 NET ASSETS WITH DONOR RESTRICTIONS (CONTINUED)

**Interpretation of Relevant Law (Continued)**

The Corporation had the following changes in perpetual endowment fund earnings during the years ended December 31:

| | 2018 | 2017 |
|---|---|---|
| Contributions to Perpetual Endowment Fund | $ 317,775 | $ 96,007 |

Description of amounts classified as perpetual endowment funds and time restricted endowment fund earnings is as follows at December 31:

| | 2018 | 2017 |
|---|---|---|
| The Portion of Perpetual Endowment Funds that is Required to be Retained Permanently, Either by Explicit Donor Stipulation or by SPMIFA | $ 12,295,422 | $ 11,977,647 |
| The Portion of Perpetual Endowment Funds to a Time Restricted Under SPMIFA without Purpose Restrictions | $ 2,839,653 | $ 3,781,096 |

**Funds with Deficiencies**

From time to time, the fair value of assets associated with individual donor-restricted funds may fall below the level that the donor or SPMIFA requires the Corporation to retain as a fund of perpetual duration. In accordance with accounting principles generally accepted in the United States of America, deficiencies of this nature are reported in undesignated net assets until restored with future restricted investment gains.

**Return Objectives and Risk Parameters**

The Corporation has adopted investment and spending policies for the endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the Corporation must hold in perpetuity or for a donor specific period(s), as well as board designated funds. Under this policy, as approved by the board of directors, the endowment assets are invested in a manner that is intended to produce results that exceed the price and yield results of various market indexes while assuming a moderate level of investment risk. The Corporation expects its endowment funds, over time, to provide an average rate of return comparable to the benchmarks outlined in the investment policy. Actual returns in any given year may vary from these benchmarks.

## NOTE 11 NET ASSETS WITH DONOR RESTRICTIONS (CONTINUED)

**Spending Policy and How the Investment Objective Relate to Spending Policy**

The Corporation has a policy of appropriating for distribution each year up to 3% of its year-end endowment fund fair value within the Corporation's control. In establishing this policy, the Corporation considers its long-term expected return on its endowments. Accordingly, over the long-term, the Corporation expects the current spending policy to allow its endowment to grow comparable to the benchmarks outlined in the investment policy. This is consistent with the Corporation's objective to maintain the purchasing power of the endowment assets in perpetuity or for a specified term, as well as to provide additional real growth through new gifts and investment return.

## NOTE 12 LEASE AND SERVICE AGREEMENTS

In September 2011, the Corporation entered into two separate Lease and Service Agreements covering approximately 9,436 square feet of space in one of its facilities. The tenants provide services that complement the services provided by the Corporation. The agreements have a term of five years but either party can terminate the agreement with ninety (90) days prior written notice. In September 2016, both Lease and Service Agreements were renewed for another five years. During the terms of the agreements, the tenants pay no monetary rent to the Corporation, but pay the Corporation a total of $2,000 per month for housekeeping, repairs, maintenance, and utilities. The Corporation also received security deposits from these tenants totaling $2,000.

## NOTE 13 FINANCIAL ASSISTANCE AND CHARITY CARE

One of the purposes of the Corporation is to provide financial assistance to residents who may not otherwise be able to obtain services offered by the Corporation. Financial assistance is provided through the Covenant Assistance Program. Covenant financial assistance is based on "need" and is provided to residents who meet the need criteria established by management. The Corporation provided Covenant financial assistance during the years 2018 and 2017 in the amounts of $507,192 and $655,002, respectively. In connection with the Covenant financial assistance, interest and dividend income from investments of Covenant endowment net assets may be used to offset the cost of such assistance. In addition to the Covenant Assistance Program, donors are able to donate to a direct charity care fund to assist indigent residents.

The cost of charity care provided was approximately $6,309,000 and $5,440,000 in 2018 and 2017, respectively. The total cost estimate is based upon actual per patient day custodial care costs. The net cost of charity care was approximately $5,830,000 and $4,989,000 in 2018 and 2018, respectively. This is net of any restricted contributions and accumulated covenant fund income received and released to assist with such costs, which were approximately $479,000 in 2018 and $451,000 in 2017.

## NOTE 14 COMMITMENTS AND CONTINGENCIES

### Retirement Plan

The Corporation has established a 401(k) pension plan, which covers substantially all eligible employees. For the calendar years 2018 and 2017, the Corporation matched 50% of employee voluntary contributions up to 4% of compensation. The Corporation's matching contributions for the years ended December 31, 2018 and 2017 totaled $106,537 and $129,831, respectively.

### Letters of Credit

Texas Capital Bank has one letter of credit outstanding in connection with the Corporation's workers' compensation insurance program. This letter of credit, in the amount of $400,000, has been extended and covers claims through August 31, 2019 and it expires on that date. Texas Capital Bank has also issued a letter of credit that is outstanding and related to the Corporation's professional and general liability insurance program. This letter of credit, in the amount of $100,000 was paid off during 2017.

### Unasserted Claims

The Corporation is subject to various legal proceedings and claims which arise in the ordinary course of operations. In the opinion of management, the amount of any liability, if any, with respect to these actions would not materially affect the financial position or results of operations of the Corporation.

### Health Care

The health care industry is subject to numerous laws and regulations by federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for resident services, and Medicare and Medicaid fraud and abuse. Recently, government activity has increased with respect to investigations by health care providers. Violations of these laws and regulations could result in expulsion from government health care programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management is not aware of any violations of these laws and regulations.

## NOTE 15 FUNDS HELD FOR OTHERS

The Corporation administers cash accounts on behalf of employees and residents and these accounts are not reflected in the consolidated financial statements. The accounts maintained on behalf of residents are subject to audit by governmental regulators.

**MORNINGSIDE MINISTRIES AND SUBSIDIARIES**
**CONSOLIDATING BALANCE SHEET**
**DECEMBER 31, 2018**
**(SEE INDEPENDENT AUDITORS' REPORT)**

| | Morningside Ministries | mmCare, LLC | Eliminations | Total |
|---|---|---|---|---|
| **ASSETS** | | | | |
| **CURRENT ASSETS** | | | | |
| Cash and Cash Equivalents | $ 7,983,470 | $ 90,947 | $ - | $ 8,074,417 |
| Resident Accounts Receivable, Net | 1,384,872 | 352,346 | - | 1,737,218 |
| Accounts Receivable, Other | 9,705 | - | - | 9,705 |
| Note Receivable - Related Party | 27,266 | - | (27,266) | - |
| Current Portion of Assets Limited as to Use | 2,095,208 | - | - | 2,095,208 |
| Supplies | 362,312 | - | - | 362,312 |
| Prepaid Expenses | 483,935 | - | - | 483,935 |
| Total Current Assets | 12,346,768 | 443,293 | (27,266) | 12,762,795 |
| **INVESTMENTS** | 20,430,725 | - | - | 20,430,725 |
| **ASSETS LIMITED AS TO USE** | | | | |
| Cash and Cash Equivalents - Trustee Held | 2,095,209 | - | - | 2,095,209 |
| Debt Service Reserve Fund | 3,548,238 | - | - | 3,548,238 |
| Endowment, Purpose, and Time Restricted Investments | 15,993,508 | - | - | 15,993,508 |
| Total Assets Limited as to Use | 21,636,955 | - | - | 21,636,955 |
| Less: Current Portion of Assets Limited as to Use | (2,095,208) | - | - | (2,095,208) |
| Total Assets Limited as to Use, Net of Current Portion | 19,541,747 | - | - | 19,541,747 |
| **PROPERTY, PLANT, AND EQUIPMENT** | 154,597,293 | 3,074 | - | 154,600,367 |
| Less: Accumulated Depreciation | (66,723,463) | (1,537) | - | (66,725,000) |
| Property, Plant, and Equipment, Net | 87,873,830 | 1,537 | - | 87,875,367 |
| **OTHER ASSETS** | | | | |
| Due from (to) Affiliates | 8,179 | (8,179) | - | - |
| Investment in mmCare, LLC | 498,551 | - | (498,551) | - |
| Deposits | 70,000 | - | - | 70,000 |
| Home Health License | - | 251,750 | - | 251,750 |
| Other Assets | 20,800 | - | - | 20,800 |
| Total Other Assets | 597,530 | 243,571 | (498,551) | 342,550 |
| Total Assets | $ 140,790,600 | $ 688,401 | $ (525,817) | $ 140,953,184 |

# MORNINGSIDE MINISTRIES AND SUBSIDIARIES
## CONSOLIDATING BALANCE SHEET (CONTINUED)
## DECEMBER 31, 2018
**(SEE INDEPENDENT AUDITORS' REPORT)**

| | Morningside Ministries | mmCare, LLC | Eliminations | Total |
|---|---|---|---|---|
| **LIABILITIES AND NET ASSETS** | | | | |
| **CURRENT LIABILITIES** | | | | |
| Current Maturities of Long-Term Debt | $ 949,855 | $ - | $ - | $ 949,855 |
| Accounts Payable | 997,109 | 53,709 | - | 1,050,818 |
| Note Payable - Related Party | - | 27,266 | (27,266) | - |
| Accrued Wages and Related Costs | 978,803 | 27,701 | - | 1,006,504 |
| Accrued Insurance Cost | 127,131 | - | - | 127,131 |
| Accrued Interest Payable | 1,581,329 | - | - | 1,581,329 |
| Accrued Expenses | 56,468 | - | - | 56,468 |
| Total Current Liabilities | 4,690,695 | 108,676 | (27,266) | 4,772,105 |
| **LONG-TERM LIABILITIES** | | | | |
| Resident Deposits | 66,935 | - | - | 66,935 |
| Refundable Entrance Fee Payable | 29,592,005 | - | - | 29,592,005 |
| Deferred Revenue | 4,057,412 | - | - | 4,057,412 |
| Long-Term Debt | 72,955,777 | - | - | 72,955,777 |
| Total Long-Term Liabilities | 106,672,129 | - | - | 106,672,129 |
| Total Liabilities | 111,362,824 | 108,676 | (27,266) | 111,444,234 |
| **NET ASSETS** | | | | |
| Without Donor Restrictions: | | | | |
| Undesignated | 13,434,266 | 498,551 | (498,551) | 13,434,266 |
| Noncontrolling Interest | - | 81,174 | - | 81,174 |
| Total Without Donor Restrictions | 13,434,266 | 579,725 | (498,551) | 13,515,440 |
| With Donor Restrictions: | | | | |
| Purpose Restrictions | 565,201 | - | - | 565,201 |
| Time Restrictions | 3,132,887 | - | - | 3,132,887 |
| Perpetual Endowment Funds | 12,295,422 | - | - | 12,295,422 |
| Total With Donor Restrictions | 15,993,510 | - | - | 15,993,510 |
| Total Net Assets | 29,427,776 | 579,725 | (498,551) | 29,508,950 |
| Total Liabilities and Net Assets | $ 140,790,600 | $ 688,401 | $ (525,817) | $ 140,953,184 |

# MORNINGSIDE MINISTRIES AND SUBSIDIARIES
# CONSOLIDATING STATEMENT OF OPERATIONS
# YEAR ENDED DECEMBER 31, 2018
## (SEE INDEPENDENT AUDITORS' REPORT)

| | Morningside Ministries | mmCare, LLC | Eliminations | Total |
|---|---|---|---|---|
| **WITHOUT DONOR RESTRICTIONS REVENUES** | | | | |
| Net Resident Service Revenue | $ 22,418,215 | $ 1,970,944 | $ - | $ 24,389,159 |
| Rental Income | 933,333 | - | - | 933,333 |
| Management Fee Revenue | 13,593,660 | - | - | 13,593,660 |
| Incentive Fee Revenue | 39,432 | - | - | 39,432 |
| Amortization of Advance Entrance Fee Revenue | 487,839 | - | - | 487,839 |
| Other Operating Revenue | 495,931 | 59,147 | - | 555,078 |
| Net Assets Released from Restrictions - Operations | 753,437 | - | - | 753,437 |
| Total Operating Revenue | 38,721,847 | 2,030,091 | - | 40,751,938 |
| **OPERATING EXPENSES** | | | | |
| Nursing Services | 11,356,237 | 349,376 | - | 11,705,613 |
| Food Services | 5,596,591 | - | - | 5,596,591 |
| Environmental Services | 6,508,011 | 16,500 | - | 6,524,511 |
| Ancillary Services | 4,719,602 | 608,654 | - | 5,328,256 |
| Life Enrichment | 1,110,115 | 37,107 | - | 1,147,222 |
| Training Institutes and Other | 298,386 | - | - | 298,386 |
| General and Administrative | 7,678,755 | 647,779 | - | 8,326,534 |
| Depreciation | 5,282,927 | 1,550 | - | 5,284,477 |
| Interest | 4,082,377 | 2,252 | (2,252) | 4,082,377 |
| Total Operating Expenses | 46,633,001 | 1,663,218 | (2,252) | 48,293,967 |
| **NET INCOME (LOSS) FROM OPERATIONS** | (7,911,154) | 366,873 | 2,252 | (7,542,029) |
| **OTHER INCOME (EXPENSE)** | | | | |
| Unrestricted Investment Earnings | (741,936) | - | (2,252) | (744,188) |
| Unrestricted Contributions | 111,316 | - | - | 111,316 |
| Gain on Sale of Property and Equipment | 38,197 | - | - | 38,197 |
| Total Other Income | (592,423) | - | (2,252) | (594,675) |
| **EXCESS (DEFICIT) OF REVENUES OVER EXPENSES** | (8,503,577) | 366,873 | - | (8,136,704) |
| Forfeiture of Chandler Trusts - Corpus | (2,729,874) | | | (2,729,874) |
| Change in Investment in mmCare, LLC | 275,155 | - | (275,155) | - |
| Net Assets Released from Restrictions - Capital | 29,199 | - | - | 29,199 |
| **INCREASE (DECREASE) IN NET ASSETS WITHOUT DONOR RESTRICTIONS** | $ (10,929,097) | $ 366,873 | $ (275,155) | $ (10,837,379) |

**MORNINGSIDE MINISTRIES AND SUBSIDIARIES**
**CONSOLIDATING STATEMENT OF CHANGES IN NET ASSETS**
**YEAR ENDED DECEMBER 31, 2018**
**(SEE INDEPENDENT AUDITORS' REPORT)**

| | Morningside Ministries | mmCare, LLC | Eliminations | Total |
|---|---|---|---|---|
| **NET ASSETS WITHOUT DONOR RESTRICTIONS** | | | | |
| Deficit of Revenues over Expenses | $ (8,503,577) | $ 366,873 | $ - | $ (8,136,704) |
| Forfeiture of Chandler Trusts - Corpus | (2,729,874) | - | - | (2,729,874) |
| Change in Investment in mmCare, LLC | 275,155 | | (275,155) | - |
| Net Assets Released from Restrictions - Capital | 29,199 | - | - | 29,199 |
| Increase (Decrease) in Net Assets Without Donor Restrictions | (10,929,097) | 366,873 | (275,155) | (10,837,379) |
| **NET ASSETS WITH DONOR RESTRICTIONS - PURPOSE RESTRICTIONS** | | | | |
| Contributions | 169,469 | - | - | 169,469 |
| Forfeiture of Chandler Trusts - Corpus | (2,350,612) | - | - | (2,350,612) |
| Net Assets Released from Restrictions - Operations | (281,836) | - | - | (281,836) |
| Net Assets Released from Restrictions - Capital | (29,199) | - | - | (29,199) |
| Decrease in Net Assets With Donor Restrictions - Purpose Restrictions | (2,492,178) | - | - | (2,492,178) |
| **NET ASSETS WITH DONOR RESTRICTIONS - TIME RESTRICTIONS** | | | | |
| Loss on Endowment Investments | (469,842) | - | - | (469,842) |
| Forfeiture of Chandler Trusts - Corpus | (175,941) | - | - | (175,941) |
| Net Assets Released from Restrictions - Operations | (471,601) | - | - | (471,601) |
| Decrease in Net Assets With Donor Restrictions - Time Restrictions | (1,117,384) | - | - | (1,117,384) |
| **NET ASSETS WITH DONOR RESTRICTIONS - PERPETUAL ENDOWMENT FUNDS** | | | | |
| Contributions | 317,775 | - | - | 317,775 |
| Increase in Net Assets With Donor Restrictions - Perpetual Endowment Funds | 317,775 | - | - | 317,775 |
| **INCREASE (DECREASE) IN NET ASSETS** | (14,220,884) | 366,873 | (275,155) | (14,129,166) |
| Net Assets - Beginning of Year | 43,648,660 | 212,852 | (223,396) | 43,638,116 |
| **NET ASSETS - END OF YEAR** | $ 29,427,776 | $ 579,725 | $ (498,551) | $ 29,508,950 |