Audited Financial Statements

June 30, 2016

The Arc of Washington County, Inc.

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Smith Elliott Kearns & Company, LLC
Certified Public Accountants & Consultants

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
The Arc of Washington County, Inc.
Hagerstown, Maryland

REPORT ON THE FINANCIAL STATEMENTS

We have audited the accompanying financial statements of The Arc of Washington County, Inc. (a nonprofit Organization), which comprise the statements of financial position as of June 30, 2016 and 2015, and the related statements of activities, functional expenses, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Arc of Washington County, Inc. at June 30, 2016 and 2015, and the changes in its net assets, functional expenses, and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The supplementary information in Schedules I through VI is presented for purposes of additional analysis and is not a required part of the 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 financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the 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 financial statements as a whole.

OTHER REPORTING REQUIRED BY GOVERNMENT AUDITING STANDARDS

In accordance with *Government Auditing Standards*, we have also issued our report dated November 28, 2016 on our consideration of the Organization's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Organization's internal control over financial reporting and compliance.

Smith Elliott Kearns & Company, LLC

Hagerstown, Maryland
November 28, 2016

THE ARC OF WASHINGTON COUNTY, INC.
Statements of Financial Position
June 30, 2016 and 2015

	2016	2015
ASSETS		
Current Assets		
Cash and cash equivalents	$ 2,405,964	$ 1,525,388
Investments	1,780,272	1,728,208
Accounts receivable	572,133	557,944
Due from/(to) funding agencies	(234,825)	82,049
Note receivable - Executive Director	2,004	2,004
Prepaid expenses	108,975	112,021
Inventory	59,965	66,376
Total Current Assets	4,694,488	4,073,990
Property and Equipment, Net	10,683,508	11,018,092
Other Assets		
Security deposits	620	620
Cash surrender value of life insurance	155,139	152,315
Annuity, net of present value adjustment	21,117	25,593
Note receivable - Executive Director	2,329	4,329
Total Other Assets	179,205	182,857
TOTAL ASSETS	$ 15,557,201	$ 15,274,939

	2016	2015
LIABILITIES AND NET ASSETS		
Current Liabilities		
Accounts payable	$ 135,807	$ 381,715
Accrued salaries and related expenses	862,409	960,860
Client funds payable	210,195	161,283
Mortgages and notes payable, current portion	328,265	368,176
Capital lease obligation, current portion	17,233	15,741
Total Current Liabilities	1,553,909	1,887,775
Long-Term Liabilities		
Mortgages and notes payable, net of current portion	3,674,667	3,900,536
Participation liability	59,011	54,561
Capital lease obligation, net of current portion	1,507	18,741
Deferred compensation liability	21,117	25,593
Total Long-Term Liabilities	3,756,302	3,999,431
Total Liabilities	5,310,211	5,887,206
Net Assets		
Unrestricted - undesignated	9,745,721	8,774,880
Unrestricted - board designated	461,194	461,047
Temporarily restricted	29,962	141,693
Permanently restricted	10,113	10,113
Total Net Assets	10,246,990	9,387,733
TOTAL LIABILITIES AND NET ASSETS	$ 15,557,201	$ 15,274,939

THE ARC OF WASHINGTON COUNTY, INC.
Statement of Activities
Year Ended June 30, 2016

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
REVENUES, GAINS AND OTHER SUPPORT				
Fees and grants	$ 23,328,886	$ -	$ -	$ 23,328,886
Resident care fees	2,339,498	-	-	2,339,498
Gain on disposal of property	100,429	-	-	100,429
Contributions	85,359	-	-	85,359
Sheltered workshop	75,956	-	-	75,956
Rental income	301,900	-	-	301,900
Other revenue	116,873	-	-	116,873
Concessions income	111,959	-	-	111,959
Fundraising income	148,792	-	-	148,792
Investment income	24,091	-	-	24,091
Realized and unrealized gain on investments	45,972	243	-	46,215
Membership dues	2,880	-	-	2,880
Total Revenues, Gains and Other Support	26,682,595	243	-	26,682,838
EXPENSES				
Program Services				
Residential	12,894,879	-	-	12,894,879
CSLA	3,559,703	-	-	3,559,703
Day	3,404,943	-	-	3,404,943
Other programs	3,048,800	-	-	3,048,800
Total Program Services	22,908,325	-	-	22,908,325
Supporting Services				
Management and general	2,761,414	-	-	2,761,414
Fundraising	153,842	-	-	153,842
Total Supporting Services	2,915,256	-	-	2,915,256
Total Expenses	25,823,581	-	-	25,823,581
NET ASSETS RELEASED FROM RESTRICTIONS	111,974	(111,974)	-	-
Change in Net Assets	970,988	(111,731)	-	859,257
NET ASSETS - BEGINNING OF YEAR	9,235,927	141,693	10,113	9,387,733
NET ASSETS - END OF YEAR	$ 10,206,915	$ 29,962	$ 10,113	$ 10,246,990

THE ARC OF WASHINGTON COUNTY, INC.
Statement of Activities
Year Ended June 30, 2015

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
REVENUES, GAINS AND OTHER SUPPORT				
Fees and grants	$ 23,130,156	$ -	$ -	$ 23,130,156
Resident care fees	2,492,094	-	-	2,492,094
(Loss) on disposal of property	(9,573)	-	-	(9,573)
Contributions	83,949	-	-	83,949
Sheltered workshop	146,634	-	-	146,634
Rental income	94,303	-	-	94,303
Other revenue	29,615	-	-	29,615
Concessions income	110,120	-	-	110,120
Fundraising income	185,798	-	-	185,798
Investment income	20,080	-	-	20,080
Realized and unrealized gain (loss) on investments	(6,654)	3,229	-	(3,425)
Membership dues	3,965	-	-	3,965
Total Revenues, Gains and Other Support	26,280,487	3,229	-	26,283,716
EXPENSES				
Program Services				
Residential	12,817,545	-	-	12,817,545
CSLA	3,380,155	-	-	3,380,155
Day	3,400,432	-	-	3,400,432
Other programs	3,438,870	-	-	3,438,870
Total Program Services	23,037,002	-	-	23,037,002
Supporting Services				
Management and general	2,612,128	-	-	2,612,128
Fundraising	156,848	-	-	156,848
Total Supporting Services	2,768,976	-	-	2,768,976
Total Expenses	25,805,978	-	-	25,805,978
NET ASSETS RELEASED FROM RESTRICTIONS	46,313	(46,313)	-	-
Change in Net Assets	520,822	(43,084)	-	477,738
NET ASSETS - BEGINNING OF YEAR	8,715,105	184,777	10,113	8,909,995
NET ASSETS - END OF YEAR	$ 9,235,927	$ 141,693	$ 10,113	$ 9,387,733

THE ARC OF WASHINGTON COUNTY, INC.
Statement of Functional Expenses
Year Ended June 30, 2016

	Program Services					Supporting Services		
	Residential	CSLA	Day	Other Programs	Total Program	Management and General	Fundraising	Total
Salaries	$ 9,386,642	$ 2,751,090	$ 2,227,046	$ 1,962,370	$16,327,148	$ 1,291,169	$ 38,906	$17,657,223
Payroll taxes	692,330	201,359	165,725	145,409	1,204,823	90,668	2,590	1,298,081
Fringe benefits	968,559	296,074	280,796	228,527	1,773,956	202,540	4,759	1,981,255
Total Salaries and Related Expenses	11,047,531	3,248,523	2,673,567	2,336,306	19,305,927	1,584,377	46,255	20,936,559
Depreciation	414,744	57,172	194,596	75,904	742,416	220,158	4,144	966,718
Food and housekeeping	391,605	4,378	76,876	46,045	518,904	9,615	9,905	538,424
Travel and lodging	101,838	45,629	181,789	71,621	400,877	8,120	-	408,997
Occupancy	295,410	16,788	60,547	110,880	483,625	47,700	-	531,325
Supplies	97,302	8,970	22,195	28,058	156,525	224,790	89,011	470,326
Purchase of services	1,240	71,600	-	112,272	185,112	-	-	185,112
Interest	118,046	1,227	9,605	13,629	142,507	67,764	-	210,271
Repairs and maintenance	123,979	7,578	43,732	38,533	213,822	45,559	-	259,381
Insurance	71,670	29,975	43,051	42,757	187,453	80,795	-	268,248
Vehicle expense	74,734	32,233	69,443	48,770	225,180	9,190	-	234,370
Client expenses	80,710	12,734	16,335	27,747	137,526	57,736	2,936	198,198
Consultants	10,600	120	-	56,265	66,985	23,315	-	90,300
Membership and other	8,748	1,921	2,734	(406)	12,997	61,164	514	74,675
Advertising	30,066	20,111	8,450	32,205	90,832	20,849	250	111,931
Professional fees	-	-	3	5,727	5,730	81,023	827	87,580
Small equipment	26,656	744	2,020	2,487	31,907	6,273	-	38,180
Technology management	-	-	-	-	-	212,986	-	212,986
TOTAL EXPENSES	$12,894,879	$ 3,559,703	$ 3,404,943	$ 3,048,800	$22,908,325	$ 2,761,414	$ 153,842	$25,823,581

THE ARC OF WASHINGTON COUNTY, INC.
Statement of Functional Expenses
Year Ended June 30, 2015

	Program Services					Supporting Services		
	Residential	**CSLA**	**Day**	**Other Programs**	**Total Program**	**Management and General**	**Fundraising**	**Total**
Salaries	$ 9,176,203	$ 2,565,719	$ 2,202,306	$ 2,201,660	$16,145,888	$ 1,268,720	$ 57,738	$17,472,346
Payroll taxes	670,836	185,421	160,951	165,753	1,182,961	84,374	3,502	1,270,837
Fringe benefits	1,036,296	315,284	336,801	247,496	1,935,877	186,387	3,953	2,126,217
Total Salaries and Related Expenses	10,883,335	3,066,424	2,700,058	2,614,909	19,264,726	1,539,481	65,193	20,869,400
Depreciation	428,165	52,135	207,959	71,712	759,971	159,934	4,178	924,083
Food and housekeeping	381,940	4,577	73,864	67,744	528,125	10,079	-	538,204
Travel and lodging	120,289	57,879	150,993	108,739	437,900	24,439	-	462,339
Occupancy	304,687	14,529	69,069	134,160	522,445	50,783	-	573,228
Supplies	102,118	6,071	26,337	33,531	168,057	211,359	86,081	465,497
Purchase of services	-	60,084	-	141,183	201,267	-	-	201,267
Interest	129,039	1,976	13,957	14,609	159,581	40,341	-	199,922
Repairs and maintenance	180,712	9,102	33,368	35,984	259,166	53,281	-	312,447
Insurance	73,984	30,053	33,222	48,825	186,084	87,462	-	273,546
Vehicle expense	75,558	35,191	65,273	55,235	231,257	10,263	-	241,520
Client expenses	49,023	13,173	18,436	22,851	103,483	47,065	100	150,648
Consultants	21,554	1,404	334	45,448	68,740	13,012	-	81,752
Membership and other	5,810	1,305	2,409	720	10,244	52,687	275	63,206
Advertising	34,225	25,502	4,494	23,684	87,905	16,853	739	105,497
Professional fees	209	508	185	17,007	17,909	99,714	282	117,905
Small equipment	26,897	242	367	2,529	30,035	4,287	-	34,322
Technology management	-	-	107	-	107	191,088	-	191,195
TOTAL EXPENSES	$12,817,545	$ 3,380,155	$ 3,400,432	$ 3,438,870	$23,037,002	$ 2,612,128	$ 156,848	$25,805,978

Statements of Cash Flows

Years Ended June 30, 2016 and 2015

	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	$ 859,257	$ 477,738
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	966,718	924,083
(Gain) loss on disposal of property and equipment	(100,429)	9,573
Realized/unrealized (gain) loss on investments	(43,391)	3,425
Amortization of loan discount	4,450	3,301
(Increase) of life insurance cash surrender value	(2,824)	-
(Increase) decrease in operating assets:		
Accounts receivable	(14,189)	19,968
Due from funding agencies	316,874	274,245
Prepaid expenses	3,046	(23,573)
Other assets	2,000	2,000
Inventory	6,411	(16,177)
Increase (decrease) in operating liabilities:		
Accounts payable	(245,908)	(62,934)
Accrued salaries and related expenses	(98,451)	(7)
Client funds payable	48,912	46,786
Net Cash Provided By Operating Activities	1,702,476	1,658,428
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property and equipment	(669,086)	(612,955)
Proceeds from sale of property and equipment	137,381	27,591
Purchases of investments	(217,959)	(491,545)
Proceeds from sale of investments	209,286	203,578
Net Cash (Used) By Investing Activities	(540,378)	(873,331)
CASH FLOWS FROM FINANCING ACTIVITIES		
Principal payments on mortgages, notes and capital lease obligations	(402,479)	(448,441)
Proceeds from borrowing	120,957	86,025
Net Cash (Used) By Financing Activities	(281,522)	(362,416)
Net Increase In Cash and Cash Equivalnets	880,576	422,681
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	1,525,388	1,102,707
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 2,405,964	$ 1,525,388
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid during the year for interest	$ 205,305	$ 196,620

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature and Organization

The Arc of Washington County, Inc. (Organization) is organized as a non-profit, tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code, incorporated in the State of Maryland. The Organization's purpose is to serve developmentally disabled individuals through various programs operating in Washington County, Maryland. Programs include residential homes, day activities (such as medical day care and transportation), intensive behavior modification, individual and family support, and juvenile services programs. These and all other services provided by the ARC are funded primarily by the State of Maryland, Department of Health and Mental Hygiene, Developmental Disabilities Administration. Additional revenue sources include other State and County government agencies, client fees, and private contributions.

Basis of Accounting

The Organization prepares its financial statements in accordance with accounting principles generally accepted in the United States of America. This basis of accounting involves the application of accrual accounting; consequently, revenues and gains are recognized when earned, and expenses and losses are recognized when incurred.

Basis of Presentation

The financial statements are presented in accordance with generally accepted accounting principles and require net assets to be classified as either 1) unrestricted, 2) temporarily restricted, or 3) permanently restricted depending on external limitations placed on the net assets. When temporarily restricted funds are used, they are recorded in the statement of activities as assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are classified as unrestricted contributions in the accompanying financial statements.

Revenue Recognition

Contributions received are recorded as unrestricted, temporarily restricted or permanently restricted support, depending on the existence and/or nature of any donor-imposed restriction. Support that is restricted by the donor is reported as an increase in unrestricted net assets if the restriction expires in the reporting period in which the support is recognized. All other donor-restricted support is reported as an increase in temporarily or permanently restricted net assets, depending on the nature of the restriction. When a restriction expires (that is, when a stipulated time restriction ends or a purpose restriction is accomplished), temporarily restricted net assets are reclassified as unrestricted net assets and reported in the statement of activities as net assets released from restrictions. Unexpended grant awards are classified as refundable advances until expenses for the purpose of the grants since they are considered conditional promises to give. Certain revenues are split between unrestricted and temporarily restricted, with the temporarily restricted portion relating to unspent funds in the year received.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Property and Equipment

Furniture and equipment acquisitions over $1,000 and property acquisitions and renovations over $3,000 are capitalized and carried at cost. Depreciation is provided over the estimated useful lives of the assets using the straight-line method. Vehicles purchased before fiscal year beginning July 1, 2009 are depreciated over the estimated mileage method. Vehicles purchased after fiscal year beginning July 1, 2009 are depreciated on a straight-line basis over the estimated useful life of the asset. Gifts of long-lived assets such as land, buildings or equipment are recorded at their fair values and reported as unrestricted support, unless explicit donor stipulations specify how the donated assets must be used.

Use of Estimates

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

Cash and Cash Equivalents

For purposes of the statement of cash flows, cash and cash equivalents represent deposits in checking and savings accounts and certificates of deposit with maturities of ninety days or less except those in an investment portfolio.

Investments

All marketable securities received by the Organization as donations are recorded at their fair market value as of the date of gift (this value is used as the Organization's cost basis). The securities are then carried at quoted market value of the securities. Investment securities consist of individual stocks and mutual funds held for investment by the Organization, and certificates of deposit with original maturity dates greater than ninety days.

Allocation of Functional Expenses

Expenses are presented on a functional basis, separating program services from management and general and fundraising expenses. Functional expenses are either charged directly to program services as incurred or allocated based on usage for items such as occupancy, depreciation and administrative salaries.

Donated Services

The Organization receives a significant amount of donated services from unpaid volunteers who assist in fundraising and special projects. No amounts have been recognized in the statements of activities as the criteria for recognition has not been satisfied.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Accounts Receivable

Accounts receivable consists of amounts due from governmental agencies and customers for goods or services mainly provided by Program activities. It is the Organization's policy to charge off uncollectible accounts receivable when management determines the receivable will not be collected. All accounts receivable are considered collectible at June 30, 2016 and 2015. Accordingly, an allowance for uncollectible accounts has not been established.

Income Tax Status and Income Tax Position

The Organization is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code. Accordingly, no provision for income taxes is reflected in these financial statements. Income which is not related to exempt purposes, less applicable deductions, is subject to federal and state corporate income taxes. The Organization had no unrelated business income for the years ended June 30, 2016 and 2015.

The Organization follows the FASB Accounting Standards Codification, which provides guidance on accounting for uncertainty in income taxes recognized in an enterprise's financial statements. The Organization's policy is to recognize interest and penalties on unrecognized tax benefits in income tax expense in the financial statements. The Organization's federal and state income tax returns are subject to examination by the Internal Revenue Service and state tax authorities, generally for a period of three years after the returns are filed.

Inventory

Inventory consists of supplies needed for the operation of a training kitchen and supplies held in the bulk center. Inventory is stated at the lower of cost or market. Cost is determined using the first-in, first-out method.

Advertising

The Organization's policy is to expense advertising costs as the costs are incurred. Total advertising costs for the years ended June 30, 2016 and 2015 amounted to $111,931 and $105,497, respectively.

Reclassifications

Certain amounts in the prior year financial statements have been reclassified for comparative purposes to conform to the presentation in the current year financial statements.

NOTE 2 CONCENTRATION OF CASH BALANCES

At June 30, 2016 and 2015 and at various times during the fiscal years then ended, the Organization maintained cash-in-bank balances in excess of the federal insured limit. Accounts at each financial institution are insured by the Federal Deposit Insurance Corporation (FDIC) up to $250,000. Amounts held in excess of FDIC insurance coverage were approximately $2,119,305 and $1,133,320 at June 30, 2016 and 2015, respectively. Management considers this to be a normal business risk.

NOTE 3 INVESTMENTS

Investments are recorded at fair value. Investments consist of the following:

	Cost	Fair Value	Unrealized Gain/(Loss)
June 30, 2016			
Cash and money market	$ 1,057,042	$ 1,057,042	$ -
Equity securities	591,453	723,230	131,777
	$ 1,648,495	$ 1,780,272	$ 131,777
June 30, 2015			
Cash and money market	$ 1,101,173	$ 1,101,173	$ -
Equity securities	512,325	599,031	86,706
U.S. Treasuries	27,999	28,004	5
	$ 1,641,497	$ 1,728,208	$ 86,711

Investment income, which consisted of interest and dividends, for the years ended June 30, 2016 and 2015 was $24,091 and $20,080, respectively.

NOTE 4 FAIR VALUE MEASUREMENT

The Accounting Standards Codification (ASC) defines fair value, establishes a framework of measuring fair value, establishes a three-level valuation hierarchy for disclosure of fair value measurement and enhances disclosure requirements for fair value measurements. The valuation hierarchy is based upon the transparency of inputs in the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

- ***Level 1*** – Represented by quoted prices that are available in an active market. Level 1 securities include highly-liquid government bonds, treasury securities, mortgage products and exchange traded equities.

NOTE 4 FAIR VALUE MEASUREMENT (CONTINUED)

- ***Level 2*** – Represented by assets and liabilities similar to Level 1 where quoted prices are not available, but are observable, either directly or indirectly through corroboration with observable market data, such as quoted prices for similar securities and quoted prices in inactive markets and estimated using pricing models or discounted cash flows. Level 2 securities would include U.S. agency securities, mortgage-backed agency securities, obligations of state and political subdivisions and certain corporate securities, asset-backed securities, money market funds and swap agreements.

- ***Level 3*** – Represented by financial instruments where there is limited activity or unobservable market prices and pricing models significant to determining the fair value measurement include the reporting entity's own assumptions about the market risk. Level 3 securities would include hedge funds, private equity securities, and private investments in public entities.

Inputs are used in applying the various valuation techniques and broadly refer to the assumptions that market participants use to make valuation decisions, including assumptions about risk. Inputs may include price information, volatility statistics, specific and broad credit data, liquidity statistics, and other factors. A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. However, the determination of what constitutes "observable" requires significant judgment by the Organization. The Organization considers observable data to be that market data, which is readily available, regularly distributed or updated, reliable and verifiable, not proprietary, and provided by independent sources that are actively involved in the relevant market. The categorization of a financial instrument within the hierarchy is based upon the pricing transparency of the instrument and does not necessarily correspond to the Organization's perceived risk of that instrument.

In determining the appropriate levels, the Organization performs a detailed analysis of the assets and liabilities that are required to be measured at fair value. There are no Level 3 inputs for any assets held by the Organization at June 30, 2016 and 2015. The table below presents the balances of assets measured at fair value on a recurring basis by level within the hierarchy.

Description	Fair Value 6/30/2016	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Investments				
Cash and money market	$ 1,057,042	$ -	$ 1,057,042	$ -
Equity securities:				
Technology	114,753	114,753	-	-
Healthcare	71,668	71,668	-	-
Consumer Goods	126,498	126,498	-	-
Financial	117,074	117,074	-	-
Utilities	76,679	76,679	-	-
Basic Materials	33,881	33,881	-	-
Services	136,750	136,750	-	-
Industrial Goods	45,927	45,927	-	-
TOTAL INVESTMENTS	$ 1,780,272	$ 723,230	$ 1,057,042	$ -

NOTE 4 FAIR VALUE MEASUREMENT (CONTINUED)

Description	Fair Value 6/30/2015	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Investments				
Cash and money market	$ 1,101,173	$ -	$ 1,101,173	$ -
Equity securities:				
Technology	76,282	76,282	-	-
Healthcare	44,456	44,456	-	-
Consumer Goods	132,093	132,093	-	-
Financial	141,910	141,910	-	-
Utilities	57,105	57,105	-	-
Basic Materials	46,973	46,973	-	-
Services	75,080	75,080	-	-
Industrial Goods	25,132	25,132	-	-
U.S. Treasuries	28,004	28,004	-	-
TOTAL INVESTMENTS	$ 1,728,208	$ 627,035	$ 1,101,173	$ -

The fair values for Level 1 investments are determined by reference to quoted market prices and other relevant information generated by active market transactions. The fair values for Level 2 investments are determined by reference to quoted market prices from markets not as active as Level 1 transactions.

Total unrealized gains (losses) for the assets listed above, that are included in the change in net assets at June 30, 2016 and 2015 were $47,722 and $(17,283), respectively. The total realized gains (losses) for the assets listed above, that are included in the change in net assets at June 30, 2016 and 2015 were $(1,507) and $13,858, respectively.

NOTE 5 NOTE RECEIVABLE – EXECUTIVE DIRECTOR

In June 2014, the Organization entered into a loan agreement with the current Executive Director in the amount of $10,000 for the purpose of facilitating his relocation to the area. Under the agreement, beginning in September 2013, the loan amount will be forgiven at a rate of $167 per month, plus interest, through August 2018 as long as the Executive Director remains employed by Organization. Interest shall accrue monthly on the unpaid balance starting from the date of disbursement at a rate equal to the Average Annual Fed Funds Effective Rate plus 6% per annum, subject to a maximum rate of 11% per annum. If the Executive Director is terminated during the five year period of this loan, the remaining principal amount of the loan along with interest is due back to the Organization.

NOTE 6 PROPERTY AND EQUIPMENT

Property and equipment are summarized below at June 30:

	2016	2015
Land	$ 2,593,824	$ 2,606,854
Buildings and improvements	15,914,944	15,847,947
Furniture and equipment	2,492,596	2,433,319
Vehicles	4,510,556	4,483,949
	25,511,920	25,372,069
Less accumulated depreciation	(14,828,412)	(14,353,977)
Property and equipment, net	$ 10,683,508	$ 11,018,092

Depreciation expense for the years ended June 30, 2016 and 2015 was $966,718 and $924,083, respectively.

NOTE 7 MORTGAGES AND NOTES PAYABLE

Mortgages and notes payable at June 30 are as follows:

	2016	2015
Group Home Financing Program (GHFP) mortgages secured by residences. Aggregate monthly payments of $2,076 include principal and interest ranging from 5% to 7%. The mortgages mature in 2023. Total book value of the residences securing these mortgages is $107,400 at June 30, 2016.	$ 146,007	$ 161,210
Other mortgages and auto loans secured by residences and vehicles. Aggregate monthly payments of $49,011 include principal and interest ranging from 2.35% to 7%. Maturities range from 2016 through 2032. Total book value of the residences and vehicles securing these loans is $4,758,032 at June 30, 2016.	3,856,925	4,107,502
Total mortgages and notes payable	4,002,932	4,268,712
Less current maturities	(328,265)	(368,176)
Mortgages and notes payable, long-term	$ 3,674,667	$ 3,900,536

NOTE 7 MORTGAGES AND NOTES PAYABLE (CONTINUED)

The principal payments on the mortgages and notes payable for the next five years and thereafter are as follows:

Year Ending June 30,	
2017	$ 328,265
2018	304,022
2019	311,205
2020	318,956
2021	308,105
Thereafter	2,432,379
	$ 4,002,932

NOTE 8 EQUITY PARTICIPATION AGREEMENT

The Maryland Community Development Administration has provided financing under the Maryland GHFP enabling the Organization to purchase residences, which it utilizes as group homes or alternative living units for its clients. All CDA GHFP mortgages contain provisions which specify that if a GHFP mortgage is prepaid, defaulted on, refinanced, matures, or if the property is sold, the State of Maryland is entitled to receive 50% of the net appreciation on the property securing that particular GHFP mortgage. At June 30, 2016 and 2015, the Organization has recorded a participation liability of $80,478 and $85,712 respectively, net of a present value discount to the date of maturity of $21,467 and $31,151, respectively, in connection with these agreements.

NOTE 9 LINES OF CREDIT

As of June 30, 2016 and 2015, the Organization had open lines of credit as follows:

	2016		2015	
	Commitment	Amount Accessed	Commitment	Amount Accessed
BB&T (operating)	$ 750,000	$ -	$ 750,000	$ -
BB&T (for vehicles only)	$ 700,000	$ 139,058	$ 700,000	$ 181,914
BB&T (unemployment insurance)	$ 300,605	$ -	$ 310,029	$ -
M&T Bank (payroll)	$ 495,000	$ -	$ 475,000	$ -
M&T Bank (for homes only)	$ 600,000	$ 64,557	$ 600,000	$ 80,145
M&T Bank (for vehicles only)	$ 300,000	$ 23,384	$ 300,000	$ -
The Columbia Bank (short term debt only)	$ 25,000	$ -	$ 25,000	$ -
The Columbia Bank (for equipment only)	$ 450,000	$ -	$ 450,000	$ -

The amounts accessed as noted above have been termed into notes payable (Note 7) at June 30, 2016 and 2015. The Organization had no outstanding balances on these lines of credit at June 30, 2016 and 2015, other than these amounts.

NOTE 10 CAPITAL LEASE OBLIGATIONS

In July 2012, the Organization entered into a lease for a phone system, which is accounted for as a capital lease. The term of the lease is 60 months. Monthly payments of $1,519 include principal and interest. The total cost of the phone system was $73,035 with a remaining book value at June 30, 2016 of $29,214.

The following is a schedule by years of future minimum lease payments due under the capital leases together with the present value of the net minimum lease payments as of June 30, 2016:

Year Ending June 30,	
2017	$ 18,230
2018	1,519
Total minimum lease payments	19,749
Less amount representing interest	(1,009)
Present value of minimum lease payments	18,740
Less current portion of capital lease obligations	(17,233)
Long-term portion of capital lease obligations	$ 1,507

NOTE 11 ACCRUED VACATION

Employees of the Organization are entitled to paid vacation, depending on the length of service and job classification. At June 30, 2016 and 2015, there were $538,781 and $680,149, respectively, of vacation benefits due employees and included in accrued salaries and related expenses in the current liabilities on the statement of financial position.

NOTE 12 ANNUITY/DEFERRED COMPENSATION LIABILITY

The Organization owns an annuity in which the annuitant is a former Executive Director of the Organization. The original premium amount was paid by the Organization in September 2008 in the amount of $126,538. The monthly annuity payment is $1,250 and expires in September 2018. The total remaining annuity payments at June 30, 2016 is $33,750. The present value of the remaining annuity payments at June 30, 2016 is $21,117 and is recorded as an asset and liability on the statement of financial position. The present value is determined by discounting the future expected payments using a rate of 3.7%.

NOTE 13 OPERATING LEASES

The Organization rents office space that is accounted for as an operating lease. The lease expired on December 31, 2013 and continued thereafter on a month-to-month basis. The required minimum monthly rent payment is $620. Rent expense for each of the years ended June 30, 2016 and 2015 was $7,440.

NOTE 14 RETIREMENT PLAN

The Organization maintains a defined contribution 403(b) plan for each of its eligible employees who elect to participate. Under the provisions on the plan, employees are eligible to participate on the day they are hired. There is no minimum age or service requirement to become a participant in the plan. Employees must complete a 90 day orientation period before they can become eligible for employer matching contributions. The Organization matches each employee's contribution to the plan from $300 to $1,800 depending on years of service. Employer matching contributions are not vested until three years of employment are completed. The expense under this plan totaled $159,742 and $153,202 for the years ended June 30, 2016 and 2015, respectively.

NOTE 15 SIGNIFICANT FUNDING SOURCE

The Organization receives approximately 91% of its total revenues through the State of Maryland's Department of Health and Mental Hygiene and other government sources. The Organization is highly dependent upon government funding to continue its operations.

NOTE 16 CONTINGENCIES

The Organization receives a substantial portion of its revenue from government grants and contracts, all of which are subject to audit by the government. Until such audits have been completed and final settlement reached, there exists a contingent asset/liability to refund any amounts received in excess of allowable costs or costs in excess recorded as receivable. Management of the Organization is of the opinion that no significant liability will result from audit adjustments and that receivables are fully collectible.

NOTE 17 UNRESTRICTED NET ASSETS – BOARD DESIGNATED

The governing board set aside funds to be used for the following purposes as of June 30:

	2016	2015
Endowment	$ 461,194	$ 461,047

NOTE 18 TEMPORARILY RESTRICTED NET ASSETS

The Organization receives funds restricted for client activities and unspent endowment earnings. Total temporarily restricted net assets were $29,962 and $141,693 for the years ended June 30, 2016 and 2015, respectively.

NOTE 19 PERMANENTLY RESTRICTED NET ASSETS

The Organization has established an endowment fund to which individuals can contribute. The funds received will be invested and only the earnings from the fund will be available to the Organization for operations. Total permanently restricted net assets were $10,113 at June 30, 2016 and 2015.

NOTE 20 ENDOWMENTS

The Organization's endowments consist of donations for donor-restricted funds and amounts designated by the Board of Directors. As required by generally accepted accounting principles, net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

The Organization's Board of Directors has interpreted the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date absent explicit donor stipulations to the contrary. As a result of the interpretation, the Organization classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Organization in a manner consistent with the standard of prudence prescribed by UPMIFA.

The Organization has an informal investment policy due to the size and minimal activity in the endowment. The investment strategy is to be conservative with minimal risk.

Endowment net assets consisted of the following:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
June 30, 2016				
Donor-restricted endowment funds	$ -	$ 19,531	$ 10,113	$ 29,644
Board designated endowment funds	461,194	-	-	461,194
Total Endowment Funds	$ 461,194	$ 19,531	$ 10,113	$ 490,838
June 30, 2015				
Donor-restricted endowment funds	$ -	$ 19,288	$ 10,113	$ 29,401
Board designated endowment funds	461,047	-	-	461,047
Total Endowment Funds	$ 461,047	$ 19,288	$ 10,113	$ 490,448

NOTE 20 ENDOWMENTS (CONTINUED)

Changes in endowment net assets are as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
June 30, 2016				
Endowment net assets, beginning of year	$ 461,047	$ 19,288	$ 10,113	$ 490,448
Investment income	147	-	-	147
Net appreciation	-	243	-	243
Endowment Net Assets, End of Year	$ 461,194	$ 19,531	$ 10,113	$ 490,838
June 30, 2015				
Endowment net assets, beginning of year	$ 460,888	$ 16,059	$ 10,113	$ 487,060
Investment income	159	-	-	159
Net appreciation	-	3,229	-	3,229
Endowment Net Assets, End of Year	$ 461,047	$ 19,288	$ 10,113	$ 490,448

NOTE 21 SUBSEQUENT EVENTS

The Organization has evaluated events and transactions subsequent to June 30, 2016 through November 28, 2016, the date these financial statements were available to be issued. Based on the definitions and requirements of generally accepted accounting principles, management has not identified any events that have occurred subsequent to June 30, 2016 and through November 28, 2016 that require recognition or disclosure in the financial statements.

SUPPLEMENTARY INFORMATION

	Foundations Independent Living	Children's Residential Services	Other	Total
CONTRACT FEES AND GRANTS				
Maryland Department of Human Resources (DSS/DHR)	$ 278,102	$ 678,070	$ -	$ 956,172
Maryland Department of Juvenile Services (DJS)	309,552	-	-	309,552
Total Contract Fees and Grants	587,654	678,070	-	1,265,724
Other fees and grants	-	-	23,328,886	23,328,886
Resident care fees	-	-	1,073,774	1,073,774
Gain on disposal of property	-	-	100,429	100,429
Contributions	-	-	85,359	85,359
Sheltered workshop	-	-	75,956	75,956
Rental income	-	-	301,900	301,900
Other revenue	-	-	116,873	116,873
Concessions income	-	-	111,959	111,959
Fundraising income	-	-	148,792	148,792
Interest income	-	-	24,091	24,091
Realized/unrealized on investments	-	-	46,215	46,215
Membership dues	-	-	2,880	2,880
TOTAL REVENUES	$ 587,654	$ 678,070	$ 25,417,114	$ 26,682,838

THE ARC OF WASHINGTON COUNTY, INC.
Schedule II – Comparison of Revenues and Expenses – Actual to Budget
Department of Human Resources Contracts
Foundations Independent Living
Year Ended June 30, 2016

	Direct Services	Medical	Other	Management & General	Actual	Budget DHR	Over/ (Under)
REVENUES							
Contract fees	$ 587,654	$ -	$ -	$ -	$ 587,654	$ 711,038	$ (123,384)
EXPENSES							
Employees							
Salaries	409,755	28,925	9,119	43,546	491,345	461,138	30,207
Contractual	-	3,049	-	419	3,468	27,376	(23,908)
Payroll taxes	29,328	2,097	629	3,196	35,250	35,065	185
Fringe benefits	39,261	2,831	850	4,247	47,189	46,068	1,121
Staff development costs	-	-	-	-	-	652	(652)
Total Salaries and Related Expenses	478,344	36,902	10,598	51,408	577,252	570,299	6,953
Publicity	2,398	173	58	260	2,889	2,627	262
Food	11,064	-	-	-	11,064	13,500	(2,436)
Clothing	3,088	-	-	-	3,088	10,000	(6,912)
Recreation	1,718	-	-	-	1,718	2,900	(1,182)
Personal needs allowance	1,824	-	-	-	1,824	10,400	(8,576)
Rent	22,050	-	-	-	22,050	22,500	(450)
Utilities	9,706	700	209	1,050	11,665	15,366	(3,701)
Repairs and maintenance	6,322	-	-	625	6,947	3,837	3,110
Insurance and taxes	5,210	376	113	563	6,262	5,683	579
Interest	183	13	4	20	220	-	220
Supplies	3,219	232	70	348	3,869	12,083	(8,214)
Depreciation and use allowance	8,392	605	182	908	10,087	12,000	(1,913)
Equipment rental, lease and repairs	1,703	-	-	169	1,872	2,350	(478)
Printing and copying	8	-	-	1	9	18	(9)
Telephone	3,967	286	85	430	4,768	5,350	(582)
Postage and shipping	-	-	-	474	474	488	(14)
Memberships and subscriptions	1,317	95	32	143	1,587	-	1,587
Conferences and conventions	1,184	85	25	128	1,422	800	622
Travel and transportation	7,968	575	172	862	9,577	14,214	(4,637)
Other	11,738	846	255	1,270	14,109	6,623	7,486
Total Expenses	581,403	40,888	11,803	58,659	692,753	711,038	(18,285)
TOTAL REVENUES OVER EXPENSES	$ 6,251	$ (40,888)	$ (11,803)	$ (58,659)	$ (105,099)	$ -	$ (105,099)

Per DHR contract, Arc of Washington County, Inc. may retain 10% of revenues earned, which amounts to $58,765. Net deficit expenses over revenues is $(105,099), therefore, no balance is due to DHR for the year ended June 30, 2016.

The budget that was submitted was based on 95.74% occupancy rate. Occupancy was lower than budgeted, therefore actual revenue is lower than the budgeted amount.

The Arc of Washington County, Inc.
Schedule II – Comparison of Revenues and Expenses – Actual to Budget
Department of Human Resources Contracts
Children's Residential Services
Year Ended June 30, 2016

	Direct Services	Medical	Other	Management & General	Actual	Budget DHR	Over/ (Under)
REVENUES							
Contract fees	$ 678,070	$ -	$ -	$ -	$ 678,070	$ 1,007,981	$ (329,911)
EXPENSES							
Employees							
Salaries	419,921	23,162	9,395	45,527	498,005	620,543	(122,538)
Contractual	-	4,537	-	1,444	5,981	19,768	(13,787)
Payroll taxes	30,246	1,669	677	3,279	35,871	48,500	(12,629)
Fringe benefits	37,002	2,041	828	4,012	43,883	75,000	(31,117)
Staff development costs	-	-	-	-	-	1,000	(1,000)
Contracted services (non-professional)	-	-	-	-	-	800	(800)
Total Salaries and Related Expenses	487,169	31,409	10,900	54,262	583,740	765,611	(181,871)
Publicity	3,044	-	100	189	3,333	1,500	1,833
Food	10,473	-	-	-	10,473	32,000	(21,527)
Clothing	3,141	-	-	-	3,141	12,000	(8,859)
Recreation	1,777	-	-	-	1,777	8,000	(6,223)
Personal needs allowance	3,041	-	-	-	3,041	9,500	(6,459)
Rent	27,500	-	-	-	27,500	27,900	(400)
Utilities	16,703	-	547	1,034	18,284	22,500	(4,216)
Repairs and maintenance	10,239	-	337	633	11,209	10,000	1,209
Insurance and taxes	6,917	-	226	428	7,571	8,700	(1,129)
Interest	6,425	-	-	-	6,425	7,500	(1,075)
Supplies	9,322	-	305	577	10,204	20,000	(9,796)
Depreciation and use allowance	20,380	-	668	1,261	22,309	24,000	(1,691)
Equipment rental, lease and repairs	3,270	-	108	202	3,580	6,000	(2,420)
Printing and copying	-	-	-	10	10	20	(10)
Telephone	5,128	-	169	317	5,614	7,200	(1,586)
Postage and shipping	361	-	-	178	539	600	(61)
Memberships and subscriptions	1,225	-	-	606	1,831	450	1,381
Conferences and conventions	1,635	-	-	-	1,635	1,500	135
Travel and transportation	11,585	-	380	717	12,682	25,000	(12,318)
Other	15,716	-	515	973	17,204	18,000	(796)
Total Expenses	645,051	31,409	14,255	61,387	752,102	1,007,981	(255,879)
TOTAL REVENUES OVER EXPENSES	$ 33,019	$ (31,409)	$ (14,255)	$ (61,387)	$ (74,032)	$ -	$ (74,032)

Per DHR contract, Arc of Washington County, Inc. may retain 10% of revenues earned, which amounts to $67,807. Net deficit expenses over revenues is $(74,032), therefore, no balance is due to DHR for the year ended June 30, 2016.

The budget that was submitted was based on 96.65% occupancy rate. Occupancy was lower than budgeted, therefore actual revenue is lower than the budgeted amount.

Actual cost of care per month is determined by:

Actual Cost of Care	=	$ 692,753	=	$ 7,281 per month
Client Months Served		95.15 months		

Cost Attributable to State of Maryland DSS/DHR

Days Attended	=	1,371	=	47.37%
Total Days		2,894		

Total Expenses	$ 692,753
Total Attributable Cost	$ 328,184

Cost Attributable to State of Maryland DJS

Days Attended	=	1,523	=	52.63%
Total Days		2,894		

Total Expenses	$ 692,753
Total Attributable Cost	$ 364,569

Actual cost of care per month is determined by:

Actual Cost of Care	=	$ 752,102	=	$ 8,004 per month
Client Months Served		93.96 months		

Cost Attributable to Sate of Maryland DSS/DHR

Days Attended	=	2,858	=	100.00%
Total Days		2,858		

Total Expenses	$ 752,102
Total Attributable Cost	$ 752,102

Cost Attributable to State of Maryland DJS

Days Attended	=	-	=	0.00%
Total Days		2,858		

Total Expenses	$ 752,102
Total Attributable Cost	$ -

Program Services	Weighted Average Monthly Payment Rate *		Calculated Actual Monthly Cost **		Rate Variance	
Foundations Independent Living	$	6,176	$	7,281	$	(1,105)
Children's Residential Services	$	7,217	$	8,004	$	(787)

* Weighted average monthly payment rate equals total actual revenue divided by client months.
** Calculated actual monthly cost equals total actual expenses divided by client months.

Schedule V – Determination of Overpayment and Underpayment Per Service Function
Department of Human Resources Contracts
Year Ended June 30, 2016

Program Services	**Budgeted Monthly Rate**	**Weighted Average Monthly Payment Rate ***	**Child Months**	**Actual Payment**	**Actual Expense**	**Over (Under) Payment**
Foundations Independent Living	$ 6,189	$ 6,176	95.15	$ 587,654	$ 692,753	$ (105,099)
Children's Residential Services	$ 7,242	$ 7,217	93.96	$ 678,070	$ 752,102	$ (74,032)

The budgeted monthly rate for Foundations Independent Living was $6,189 from July 1, 2015 through June 30, 2016.

The budgeted monthly rate for Children's Residential Services was $7,242 from July 1, 2015 through June 30, 2016.

FY 2016 - The Foundations Independent Living program had $115,095 in retained earnings at June 30, 2015. The current year under payment of $(105,099) for the program has been subtracted from retained earnings for a total of $9,996 at June 30, 2016 which will be used to fund future operating expenses and potential funding reductions.

FY 2016 - The Children's Residential Services program had $6,875 in retained earnings at June 30, 2015. The current year under payment of $(74,032) for the program has been subtracted from retained earnings for a total of $(67,157) at June 30, 2016.

Schedule VI – Maximum Allowance Earnings Retention
Department of Human Resources Contracts
Year Ended June 30, 2016

Contract Services	DHR Revenue	Maximum Allowed Retainage	Excess (Deficit) of Revenues Over Expenses	Amount Due to DHR
Foundations Independent Living	$ 587,654	$ 58,765	$ (105,099)	$ -
Children's Residential Services	$ 678,070	$ 67,807	$ (74,032)	$ -

As per DHR regulations, providers are allowed to retain 10% of revenues for fiscal year 2016.

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To the Board of Directors
The Arc of Washington County, Inc.
Hagerstown, Maryland

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of The Arc of Washington County, Inc. (Organization), which comprise the statement of financial position as of June 30, 2016, and the related statements of activities, functional expenses and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated November 28, 2016.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit of the financial statements, we considered the Organization's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Organization's internal control. Accordingly, we do not express an opinion on the effectiveness of the Organization's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance

Our consideration of the internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Organization's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards.*

PURPOSE OF THIS REPORT

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the organization's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Smith Elliott Kearns & Company, LLC

Hagerstown, Maryland
November 28, 2016