

Houston Forensic Science Center, Inc.
(A Component Unit of the City of Houston)

Financial Statements
and Independent Auditors' Report
for the years ended June 30, 2017 and 2016

Houston Forensic Science Center, Inc.

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Independent Auditors' Report

To the Board of Directors of
Houston Forensic Science Center, Inc.:

We have audited the accompanying financial statements of the governmental activities of Houston Forensic Science Center, Inc. (a component unit of the City of Houston), as of and for the years ended June 30, 2017 and 2016 and the related notes to the financial statements, which comprise Houston Forensic Science Center, Inc.'s basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

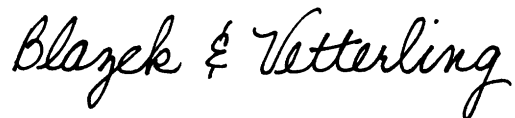
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities of Houston Forensic Science Center, Inc., as of June 30, 2017 and 2016, and the changes in its financial position for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that management's discussion and analysis on pages 3-6 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Report Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated September 15, 2017 on our consideration of Houston Forensic Science Center, Inc.'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 solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of Houston Forensic Science Center, Inc.'s 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 Houston Forensic Science Center, Inc.'s internal control over financial reporting and compliance.

The image shows a handwritten signature in cursive script that reads "Blazek & Vetterling". The signature is written in dark ink and is positioned above the date.

September 15, 2017

Houston Forensic Science Center, Inc.
Management's Discussion and Analysis
For the years ended June 30, 2017 and 2016
(unaudited)

The following discussion and analysis of Houston Forensic Science Center, Inc.'s (HFSC) financial performance provides an overview of the financial activities for the years ended June 30, 2017 and 2016. This discussion should be read in conjunction with HFSC's financial statements, which follow this section.

Financial Highlights

Financial highlights for the fiscal year ending June 30, 2017 include:

- HFSC's total fund balance decreased by \$747,000 as a result of hiring additional personnel, consultant costs, and expenditures related to software costs, offset by increased government grant revenue of \$1.4 million.
- HFSC's total net position increased by \$163,000 with revenue of \$26.7 million and expenses of \$26.5 million. Government grant revenues and the City of Houston's (the City) appropriation increased by \$1.4 million and \$740,000, respectively. Expenses increased by \$1.2 million.
- \$21.8 million of HFSC's expenses were program expenses in connection with forensic science services.
- HFSC recognized revenue of \$24.9 million in appropriations received from the City in its statement of activities.
- HFSC added \$1.4 million in capital assets during the year, which included \$14,000 in donated property from the City.

Financial highlights for the fiscal year ending June 30, 2016 include:

- HFSC's total fund balance decreased by \$1.2 million and its total net position decreased by \$711,000 as a result of hiring additional personnel, a one-time cost associated with leasing additional space, and purchases of software and supplies.
- \$21.1 million of HFSC's expenses were program expenses in connection with forensic science services.
- HFSC recognized revenue of \$24.1 million in appropriations received from the City in its statement of activities.
- HFSC added \$790,000 in capital assets during the year, which included \$7,500 in donated property from the City.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to HFSC's basic financial statements. The basic financial statements present combined government-wide and governmental fund financial statements. The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the basic financial statements.

Government-wide financial statements reflect an economic resources measurement focus and are prepared using the accrual basis of accounting. The government-wide financial statements are designed

to provide readers with a broad overview of HFSC’s finances, in a manner similar to a private-sector business.

The statement of net position shows the financial position of HFSC at year end by presenting HFSC’s assets and liabilities, with net position representing the difference between assets and liabilities. The statement of activities presents information showing changes in HFSC’s net position during the year. Changes in net position are reported when an underlying event giving rise to a change occurs, regardless of the timing of related cash flows. Therefore, revenue and expenses are reported in this statement for some items that will not result in cash flows until future fiscal periods.

Governmental fund financial statements reflect a current financial resources measurement focus and are prepared using the modified accrual basis of accounting. Unlike the government-wide financial statements, the governmental fund financial statements present information showing the near-term inflows and outflows of spendable resources and the balances of spendable resources at year end.

During 2017 and 2016, there was a difference between the government-wide financial statements and the governmental fund financial statements as a result of capital outlays of \$1,377,000 and \$778,000, respectively, being recorded as expenditures on the governmental fund balance sheet, but recorded as capital assets on the statement of net position. There is also a difference of \$433,000 and \$320,000 in depreciation expense for 2017 and 2016, respectively, and \$14,000 and \$7,500, respectively, in donated property for 2017 and 2016 from the City/Houston Police Department (HPD) recognized in the statement of activities and not in the governmental fund statement of revenue, expenditures, and changes in fund balance.

Condensed Government-Wide Financial Information and Financial Analysis

	AS OF JUNE 30		
	2017	2016	2015
<i>Condensed Statements of Net Position:</i>			
Current assets	\$ 2,677,455	\$ 3,980,876	\$ 3,862,936
Capital assets	3,826,217	2,916,334	2,450,895
Total assets	\$ 6,503,672	\$ 6,897,210	\$ 6,313,831
Total liabilities	\$ 1,930,153	\$ 2,486,635	\$ 1,192,421
Net position:			
Unrestricted	\$ 747,302	\$ 1,494,241	\$ 2,670,515
Invested in capital assets	3,826,217	2,916,334	2,450,895
Total net position	\$ 4,573,519	\$ 4,410,575	\$ 5,121,410

Fiscal Year 2017

The assets of HFSC consist primarily of cash, grants receivable from a federal government agency, prepaid expenses and capital assets. Liabilities consist primarily of operating expenses, including accrued salaries and paid time off. The decrease in assets at June 30, 2017 as compared to June 30, 2016 primarily is the result of the timing of reimbursing the City/HPD for operating expenses. Liabilities decreased primarily due to the timing of reimbursing the City/HPD for operating expenses.

Fiscal Year 2016

The assets of HFSC consist primarily of cash, grants receivable from a federal government agency, and capital assets. Liabilities consist primarily of operating expenses, including accrued salaries and paid time off. The increase in assets at June 30, 2016 as compared to June 30, 2015 primarily is the result of a receivable from the federal government agency that arose from a grant that was new in 2016. Liabilities increased primarily due to the timing of reimbursing the City/HPD for operating expenses.

	<u>FOR THE YEAR ENDED JUNE 30</u>		
	<u>2017</u>	<u>2016</u>	<u>2015</u>
<i>Condensed Statements of Activities:</i>			
Expenses:			
Program services	\$ 21,753,369	\$ 21,081,174	\$ 17,465,532
Management and general	<u>4,757,943</u>	<u>4,246,384</u>	<u>2,867,832</u>
Total expenses	<u>26,511,312</u>	<u>25,327,558</u>	<u>20,333,364</u>
Revenue:			
City of Houston – appropriation	23,420,344	22,680,344	21,248,199
City of Houston – direct overhead appropriation	1,460,000	1,460,000	1,460,000
U. S. Department of Justice – government grant revenue	1,770,631	349,651	
Other revenue from local governments		8,952	15,306
Other revenue	9,498	110,277	24,977
City/HPD – donation of property	<u>13,783</u>	<u>7,499</u>	<u>209,022</u>
Total revenue	<u>26,674,256</u>	<u>24,616,723</u>	<u>22,957,504</u>
CHANGES IN NET POSITION	162,944	(710,835)	2,624,140
Net position, beginning of year	<u>4,410,575</u>	<u>5,121,410</u>	<u>2,497,270</u>
Net position, end of year	<u>\$ 4,573,519</u>	<u>\$ 4,410,575</u>	<u>\$ 5,121,410</u>

Fiscal Year 2017

The statement of activities shows the expenses and revenue of HFSC and the corresponding effect on net position. The majority of HFSC's revenue is provided from appropriations from the City's budget. The City provides appropriated funds from its general fund, as well as an overhead allocation for space occupied at 1200 Travis St., Houston, Texas. HFSC also receives federal grant revenue funding from the U. S. Department of Justice, which is paid on a reimbursement basis.

Revenue increased as a result of HFSC receiving more appropriated funds than in the prior year, and receiving more funding from the U. S. Department of Justice.

Fiscal Year 2016

The statement of activities shows the expenses and revenue of HFSC and the corresponding effect on net position. The majority of HFSC's revenue is provided from appropriations from the City's budget. The City provides appropriated funds from its general fund, as well as an overhead allocation for space occupied at 1200 Travis St., Houston, Texas.

Revenue increased as a result of HFSC receiving more appropriated funds than in the prior year, beginning to provide forensic, consulting, and training services for other police agencies, and receiving a new grant from the U. S. Department of Justice.

Contacting Houston Forensic Science Center, Inc.'s Financial Management

The financial report is designed to discuss issues that may be material to the operation of HFSC. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Chief Financial Officer and Treasurer, Houston Forensic Science Center, Inc., 1301 Fannin St., Suite 170, Houston, Texas, 77002.

Houston Forensic Science Center, Inc.

Governmental Fund Balance Sheet and Statement of Net Position as of June 30, 2017

	GENERAL FUND	ADJUSTMENTS (NOTE 8)	STATEMENT OF NET POSITION
ASSETS			
Current assets:			
Cash	\$ 2,239,716		\$ 2,239,716
Government grants receivable	226,812		226,812
Accounts receivable	7,265		7,265
Prepaid expenses	203,662		203,662
Noncurrent assets:			
Capital assets, net of depreciation (Note 4)	<u> </u>	\$ 3,826,217	<u>3,826,217</u>
TOTAL ASSETS	<u>\$ 2,677,455</u>	<u>\$ 3,826,217</u>	<u>\$ 6,503,672</u>
LIABILITIES			
Current liabilities:			
Accounts payable and accrued expenses	\$ 1,930,153		\$ 1,930,153
TOTAL LIABILITIES	<u>1,930,153</u>		<u>\$ 1,930,153</u>
FUND BALANCE AND NET POSITION			
Nonspendable prepaid expenses	203,662	\$ (203,662)	
Unassigned / unrestricted	543,640	203,662	\$ 747,302
Invested in capital assets	<u> </u>	<u>3,826,217</u>	<u>3,826,217</u>
TOTAL FUND BALANCE	<u>747,302</u>		
TOTAL LIABILITIES AND FUND BALANCE	<u>\$ 2,677,455</u>		
TOTAL NET POSITION		<u>\$ 3,826,217</u>	<u>\$ 4,573,519</u>

See accompanying notes to financial statements.

Houston Forensic Science Center, Inc.

Governmental Fund Balance Sheet and Statement of Net Position as of June 30, 2016

	GENERAL FUND	ADJUSTMENTS (NOTE 8)	STATEMENT OF NET POSITION
ASSETS			
Current assets:			
Cash	\$ 3,507,675		\$ 3,507,675
Government grants receivable	303,413		303,413
Accounts receivable	31,790		31,790
Prepaid expenses	137,998		137,998
Noncurrent assets:			
Capital assets, net of depreciation (Note 4)	<u> </u>	\$ 2,916,334	<u>2,916,334</u>
TOTAL ASSETS	<u>\$ 3,980,876</u>	<u>\$ 2,916,334</u>	<u>\$ 6,897,210</u>
LIABILITIES			
Current liabilities:			
Accounts payable and accrued expenses	\$ 2,486,635		\$ 2,486,635
TOTAL LIABILITIES	<u>2,486,635</u>		<u>\$ 2,486,635</u>
FUND BALANCE AND NET POSITION			
Nonspendable prepaid expenses	137,998	\$ (137,998)	
Unassigned / unrestricted	1,356,243	137,998	\$ 1,494,241
Invested in capital assets	<u> </u>	<u>2,916,334</u>	<u>2,916,334</u>
TOTAL FUND BALANCE	<u>1,494,241</u>		
TOTAL LIABILITIES AND FUND BALANCE	<u>\$ 3,980,876</u>		
TOTAL NET POSITION		<u>\$ 2,916,334</u>	<u>\$ 4,410,575</u>

See accompanying notes to financial statements.

Houston Forensic Science Center, Inc.

Governmental Fund Statement of Revenue, Expenditures, and Changes in Fund Balance and Statement of Activities for the year ended June 30, 2017

	GENERAL FUND	ADJUSTMENTS (NOTE 8)	STATEMENT OF ACTIVITIES
EXPENDITURES / EXPENSES:			
Program services	\$ 21,320,451	\$ 432,918	\$ 21,753,369
Management and general	4,757,943		4,757,943
Capital expenditures	<u>1,377,100</u>	<u>(1,377,100)</u>	<u> </u>
Total expenditures / expenses	<u>27,455,494</u>	<u>(944,182)</u>	<u>26,511,312</u>
REVENUE:			
Grant from City of Houston – appropriation	23,420,344		23,420,344
Grant from City of Houston – direct overhead appropriation	1,460,000		1,460,000
U. S. Department of Justice – government grant revenue	1,770,631		1,770,631
Other revenue	57,580	(48,082)	9,498
City/HPD – donation of property	<u> </u>	<u>13,783</u>	<u>13,783</u>
Total revenue	<u>26,708,555</u>	<u>(34,299)</u>	<u>26,674,256</u>
EXCESS OF REVENUE OVER EXPENDITURES / CHANGES IN NET POSITION	(746,939)	909,883	162,944
Fund balance / net position, beginning of year	<u>1,494,241</u>	<u>2,916,334</u>	<u>4,410,575</u>
Fund balance / net position, end of year	<u>\$ 747,302</u>	<u>\$ 3,826,217</u>	<u>\$ 4,573,519</u>

See accompanying notes to financial statements.

Houston Forensic Science Center, Inc.

Governmental Fund Statement of Revenue, Expenditures, and Changes in Fund Balance and Statement of Activities for the year ended June 30, 2016

	GENERAL FUND	ADJUSTMENTS (NOTE 8)	STATEMENT OF ACTIVITIES
EXPENDITURES / EXPENSES:			
Program services	\$ 20,760,878	\$ 320,296	\$ 21,081,174
Management and general	4,246,384		4,246,384
Capital expenditures	<u>778,236</u>	<u>(778,236)</u>	<u> </u>
Total expenditures / expenses	<u>25,785,498</u>	<u>(457,940)</u>	<u>25,327,558</u>
REVENUE:			
Grant from City of Houston – appropriation	22,680,344		22,680,344
Grant from City of Houston – direct overhead appropriation	1,460,000		1,460,000
U. S. Department of Justice – government grant revenue	349,651		349,651
Other revenue from local governments	8,952		8,952
Other revenue	110,277		110,277
City/HPD – donation of property	<u> </u>	<u>7,499</u>	<u>7,499</u>
Total revenue	<u>24,609,224</u>	<u>7,499</u>	<u>24,616,723</u>
EXCESS OF REVENUE OVER EXPENDITURES / CHANGES IN NET POSITION	(1,176,274)	465,439	(710,835)
Fund balance / net position, beginning of year	<u>2,670,515</u>	<u>2,450,895</u>	<u>5,121,410</u>
Fund balance / net position, end of year	<u>\$ 1,494,241</u>	<u>\$ 2,916,334</u>	<u>\$ 4,410,575</u>

See accompanying notes to financial statements.

Houston Forensic Science Center, Inc.

Notes to Financial Statements for the years ended June 30, 2017 and 2016

NOTE 1 – ORGANIZATION

Organization – Houston Forensic Science Center, Inc. (HFSC), a component unit of the City of Houston (the City), is a local government corporation created to provide independent forensic services to law enforcement agencies, primarily the Houston Police Department (HPD), and other judicial entities. The formation of HFSC was approved by City Council on June 26, 2012.

HFSC's Board of Directors are appointed by the Mayor of the City and approved by City Council. HFSC receives funding primarily from an interlocal agreement with the City in which funding is received subject to the City's approval of HFSC's annual budget. Funding received must be expended in accordance with the annual budget.

Federal income tax status – HFSC is a local government corporation created to accomplish a governmental purpose of the City and is not subject to federal income tax. Contributions to HFSC are deductible under §501(c)(3) of the Internal Revenue Code.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation – These financial statements have been prepared in conformity with the accounting principles and reporting guidelines established by the Governmental Accounting Standards Board (GASB).

Measurement focus and basis of accounting – Measurement focus refers to *what* is being expressed in reporting financial position and performance, that is, *which* resources are being measured. The financial resources measurement focus measures only financial resources while the economic resources measurement focus measures both financial and capital resources. The measurement focus determines *whether* a fund balance sheet or statement of net position reports financial or economic resources. Basis of accounting refers to *when* those resources and commitments and uses of those resources should be recognized. It relates to the timing of the measurements made regardless of the measurement focus applied.

Governmental funds in the fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenue is recognized when it is measurable and available. *Measurable* means the amount of the transaction is known or reasonably estimable. *Available* refers to amounts collected in the current period or expected to be collected soon enough thereafter to be used to pay liabilities of the current period, generally within 60 days after year end. Expenditures are recognized when the related liability is incurred.

Governmental funds in the government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis of accounting, revenue is recognized when it is earned and becomes measurable and expenses are recognized in the period incurred.

Cash consists of demand deposits. Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, HFSC will be unable to recover deposits. At June 30, 2017, the carrying amount and the bank balance of HFSC's demand deposit account were \$2,239,716 and \$2,407,894, respectively. Amounts on deposit that are in excess of the Federal Deposit Insurance Corporation limit of \$250,000 are collateralized by a security agreement with the bank.

Fund balance is classified based upon the relative strength of spending constraints placed upon the purposes for which resources can be used, as follows:

- *Nonspendable fund balance* includes amounts that are either not in spendable form or are legally or contractually required to be maintained intact.
- *Restricted fund balance* includes amounts constrained to specific purposes by resource providers, through constitutional provisions, or by enabling legislation.
- *Unassigned fund balance* includes amounts that are available for HFSC's future use for any purpose.

Net position represents the difference between assets and liabilities. HFSC reports categories of net position, as follows:

- *Invested in capital assets* consists of net capital assets.
- *Restricted net position* – net position is considered restricted if its use is constrained to a particular purpose. Restrictions are imposed by external organizations such as City ordinances or grantors.
- *Unrestricted net position* consists of all other net position that does not meet the definition of the above two components and is available for general use by HFSC.

Capital assets include forensic science equipment, office equipment, and leasehold improvements. HFSC capitalizes capital expenditures of \$5,000 or greater with an estimated useful life of more than one year. Purchased capital expenditures are carried at cost. Donated capital assets are recorded at fair value at the date of transfer. Depreciation expense is recognized using the straight-line method over estimated useful lives of 5 to 15 years.

Grants – Under both the modified accrual and the accrual basis of accounting, receivables from grants are recognized, net of uncollectible amounts, when all applicable eligibility requirements are met provided the commitment is verifiable and the resources are measurable and probable of collection. Revenue recognized as receivable in advance of the time period during which eligibility requirements are met or resources are available, is deferred under the modified accrual basis of accounting, but is recognized as revenue under the accrual basis of accounting and reflected as restricted net position when eligibility requirements are met.

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

NOTE 3 – RELATED PARTIES

HFSC is a component unit of the City and receives appropriated funds from the City's general fund, as well as an overhead allocation representing shared costs of the use of City/HPD facilities. HFSC's forensic functions are performed primarily to support HPD.

The City charged HFSC \$6.2 million and \$9 million for services provided to HFSC for fiscal years 2017 and 2016, respectively. The City also donated \$13,800 and \$7,500 in equipment to HFSC in fiscal years 2017 and 2016, respectively. The City provided \$1.5 million in overhead appropriations representing HFSC's use of the City's property in fiscal years 2017 and 2016, respectively. In fiscal year 2017, the City also appropriated \$14.9 million for general operations and \$8.5 million for services provided by the City for total appropriations of \$23.4 million for operations. The City appropriated \$11.4 million for general operations and \$11.3 million for services provided by the City for total appropriations of \$22.7 million for operations in fiscal year 2016.

NOTE 4 – CAPITAL ASSETS

HFSC's investment in capital assets consists of the following:

	BALANCE AT JULY 1, 2016	ADDITIONS	COMPLETIONS/ DISPOSITIONS	BALANCE AT JUNE 30, 2017
Scientific forensic equipment	\$ 3,162,004	\$ 338,984	\$ 183,470	\$ 3,684,458
Furniture and office equipment	195,310	396,820		592,130
Leasehold improvements	161,214			161,214
Work-in-progress – database		684,338	(180,000)	504,338
Less accumulated depreciation	<u>(602,194)</u>	<u>(432,918)</u>	<u>(80,811)</u>	<u>(1,115,923)</u>
Capital assets, net of depreciation	<u>\$ 2,916,334</u>	<u>\$ 987,224</u>	<u>\$ (77,341)</u>	<u>\$ 3,826,217</u>

	BALANCE AT JULY 1, 2015	ADDITIONS	COMPLETIONS/ DISPOSITIONS	BALANCE AT JUNE 30, 2016
Scientific forensic equipment	\$ 2,264,505	\$ 540,863	\$ 356,636	\$ 3,162,004
Furniture and office equipment	42,764	152,546		195,310
Leasehold improvements	16,998	94,826	49,390	161,214
Work-in-progress – leasehold improvements	406,026		(406,026)	
Less accumulated depreciation	<u>(279,398)</u>	<u>(322,796)</u>		<u>(602,194)</u>
Capital assets, net of depreciation	<u>\$ 2,450,895</u>	<u>\$ 465,439</u>	<u>\$ 0</u>	<u>\$ 2,916,334</u>

NOTE 5 – COMMITMENTS

In April 2015, HFSC entered into an operating lease agreement for the use of certain building space. The agreement includes HFSC's commitment to pay predetermined monthly rent, as well as operating expenses, which are determined annually based on the prior year's operating expense. The operating lease agreement also stipulates that HFSC is to pay a termination penalty that includes tenant improvement costs and commission costs in the amount that is the lesser of \$254,174 or the unamortized balance of the scheduled lease payments, which is \$201,193 with interest of 3.0% at June 30, 2017, should it terminate the lease before the end of the lease term. Related occupancy expense of \$1,016,000 and \$957,000 were recognized during 2017 and 2016, respectively. Additionally, HFSC leases certain equipment under operating leases. Related lease expense of approximately \$26,000 and \$25,000 were recognized during 2017 and 2016, respectively. Future minimum lease payments at June 30, 2017 are due as follows:

2018	\$ 1,027,181
2019	<u>860,679</u>
Total	<u>\$ 1,887,860</u>

NOTE 6 – GOVERNMENT GRANTS

HFSC is party to contracts with a federal governmental agency. Should these contracts not be renewed, a replacement for this source of support may not be forthcoming and related expenses may not be incurred. Funding sources of government grants include amounts from the U. S. Department of Justice totaling \$1,770,000 and \$350,000 during fiscal years 2017 and 2016, respectively.

Government grants require fulfillment of certain conditions as set forth in the contracts and are subject to review and audit by the awarding agency. Such reviews and audits could result in the discovery of unallowable activities and unallowable costs. Consequently, the funding source may, at its discretion, request reimbursement for expenses or return of funds as a result of noncompliance by HFSC with the terms of the contracts.

NOTE 7 – EMPLOYEE BENEFIT PLANS

HFSC has both a deferred compensation plan and a defined contribution retirement plan covering substantially all full-time employees. Under the terms of the deferred compensation plan, HFSC matches an amount up to 5% of each participant's annual salary. Under the terms of the defined contribution retirement plan, HFSC contributes an amount equal to 2% of each participant's annual salary. HFSC's contributions to these plans were approximately \$631,000 and \$446,000 in 2017 and 2016, respectively.

NOTE 8 – ADJUSTMENTS BETWEEN THE GOVERNMENTAL FUND STATEMENTS AND THE GOVERNMENT-WIDE STATEMENT OF NET POSITION AND STATEMENT OF ACTIVITIES

Total fund balance reported in the governmental fund balance sheet differs from net position reported in the government-wide statement of net position. Differences occur because of the current financial resources focus of the governmental fund statements and the long-term economic focus of the government-wide statement of net position and statement of activities. The provisions of GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* impose this change in focus. The adjustments show the difference between the statements that result from this difference in measurement focus.

Adjustments of \$3,826,217 and \$2,916,334 relating to capital assets are reported in the statements of net position for the years ended 2017 and 2016, which differ from the respective governmental fund balance sheets. Capital assets used in governmental activities are not current financial resources, and therefore, are not reported in the fund financial statements.

Adjustments reported in the statements of activities from the governmental fund statements of revenue, expenditures, and changes in fund balance consist of the following:

	<u>2017</u>	<u>2016</u>
Governmental funds report outlays for capital assets as expenditures because such outlays use current financial resources. The statements of activities recognizes the cost of outlays allocated over estimated useful lives as depreciation expense.		
Capital outlay	\$ 1,377,100	\$ 778,236
Depreciation expense	(432,918)	(320,296)
Governmental funds do not recognize as revenue contributions of donated property because such contributions do not increase current financial resources.		
Donated property	13,783	7,499
Governmental funds do not recognize as revenue loss on disposal of assets because such losses do not decrease current financial resources:		
Loss on disposal	<u>(48,082)</u>	<u> </u>
Net adjustment to increase net changes in fund balance to change in net position of governmental activities	<u>\$ 909,883</u>	<u>\$ 465,439</u>
