

Melwood Horticultural Training Center, Inc. and Affiliates

Consolidated Financial Report
June 30, 2018

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RSM US LLP

Independent Auditor's Report

To the Board of Directors
Melwood Horticultural Training Center, Inc.

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Melwood Horticultural Training Center, Inc. and Affiliates (the Center), which comprise the consolidated balance sheets as of June 30, 2018 and 2017, the related consolidated statements of activities, functional expenses and cash flows for the years then ended, and the related notes to the consolidated financial statements (collectively, 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. 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 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 Center as of June 30, 2018 and 2017, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

RSM US LLP

Gaithersburg, Maryland
October 24, 2018

Melwood Horticultural Training Center, Inc. and Affiliates

Consolidated Balance Sheets
June 30, 2018 and 2017
(In Thousands)

	2018	2017
Assets		
Current assets:		
Cash and cash equivalents	\$ 7,296	\$ 5,013
Receivables, net	15,332	16,423
Inventory	281	299
Prepaid expenses	712	163
Total current assets	23,621	21,898
Property and equipment, net	21,173	13,225
Investments	8,591	6,016
Other assets	1,349	1,519
	\$ 54,734	\$ 42,658
Liabilities and Net Assets		
Current liabilities:		
Accounts payable and accrued expenses	\$ 7,534	\$ 7,196
Accrued payroll and withheld taxes	4,033	3,540
Notes payable, current portion	854	696
Deferred revenue	142	229
Total current liabilities	12,563	11,661
Notes payable, net of current portion	2,359	2,837
Other liabilities	87	50
	15,009	14,548
Contingencies (Note 12)		
Net assets:		
Unrestricted:		
Operating	31,134	21,869
Board designated	7,243	4,666
	38,377	26,535
Temporarily restricted	406	633
Permanently restricted	942	942
	39,725	28,110
	\$ 54,734	\$ 42,658

See notes to consolidated financial statements.

Melwood Horticultural Training Center, Inc. and Affiliates

**Consolidated Statements of Activities
Years Ended June 30, 2018 and 2017
(In Thousands)**

	2018				2017			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Support and revenue:								
Monetary contributions	\$ 393	\$ -	\$ -	\$ 393	\$ 169	\$ 125	\$ -	\$ 294
Donated items	2,799	-	-	2,799	2,904	-	-	2,904
Government and private grants	923	-	-	923	357	-	-	357
Contract revenue	88,583	-	-	88,583	76,996	-	-	76,996
Sales revenue	11	-	-	11	72	-	-	72
Service fees	11,474	-	-	11,474	8,853	-	-	8,853
Other	339	-	-	339	356	-	-	356
Net assets released from restrictions	292	(292)	-	-	900	(900)	-	-
	<u>104,814</u>	<u>(292)</u>	<u>-</u>	<u>104,522</u>	<u>90,607</u>	<u>(775)</u>	<u>-</u>	<u>89,832</u>
Investment income, net	265	65	-	330	160	129	-	289
Total support and revenue	105,079	(227)	-	104,852	90,767	(646)	-	90,121
Expenses:								
Program expenses:								
Employment services	72,712	-	-	72,712	64,580	-	-	64,580
Community services	10,711	-	-	10,711	8,431	-	-	8,431
Therapeutic services	1,262	-	-	1,262	1,215	-	-	1,215
Veterans services	1,302	-	-	1,302	347	-	-	347
Total program expenses	85,987	-	-	85,987	74,573	-	-	74,573
Supporting services:								
Management and general	15,145	-	-	15,145	11,920	-	-	11,920
Fundraising	3,456	-	-	3,456	2,848	-	-	2,848
Total supporting services	18,601	-	-	18,601	14,768	-	-	14,768
Total expenses	104,588	-	-	104,588	89,341	-	-	89,341
Change in net assets before gain on acquisition	491	(227)	-	264	1,426	(646)	-	780
Gain on acquisition	11,351	-	-	11,351	-	-	-	-
Change in net assets	11,842	(227)	-	11,615	1,426	(646)	-	780
Net assets:								
Beginning	26,535	633	942	28,110	25,109	1,279	942	27,330
Ending	<u>\$ 38,377</u>	<u>\$ 406</u>	<u>\$ 942</u>	<u>\$ 39,725</u>	<u>\$ 26,535</u>	<u>\$ 633</u>	<u>\$ 942</u>	<u>\$ 28,110</u>

See notes to consolidated financial statements.

Melwood Horticultural Training Center, Inc. and Affiliates

Consolidated Statement of Functional Expenses
Year Ended June 30, 2018
(In Thousands)

	Program Expenses				Total Program Expenses	Supporting Services			Total Expenses
	Employment Services	Community Services	Therapeutic Services	Veterans Services		Management and General	Fundraising	Total Supporting Services	
Wages and salaries	\$ 37,311	\$ 7,192	\$ 436	\$ 676	\$ 45,615	\$ 7,189	\$ 795	\$ 7,984	\$ 53,599
Employee benefits	12,345	1,328	62	123	13,858	1,326	147	1,473	15,331
Total salaries and related expenses	49,656	8,520	498	799	59,473	8,515	942	9,457	68,930
Professional and consulting fees	147	447	26	160	780	1,829	583	2,412	3,192
Supplies and materials	4,093	117	173	77	4,460	314	66	380	4,840
Buildings and occupancy	1,273	411	179	21	1,884	1,355	40	1,395	3,279
Equipment maintenance and rental	1,108	322	45	14	1,489	1,671	36	1,707	3,196
Support and contract services	15,619	171	6	15	15,811	426	1,693	2,119	17,930
Travel	65	370	159	196	790	214	63	277	1,067
Other	15	30	1	-	46	64	18	82	128
Interest and bank fees	11	1	5	-	17	258	5	263	280
Depreciation and amortization	725	322	170	20	1,237	499	10	509	1,746
Total expenses	\$ 72,712	\$ 10,711	\$ 1,262	\$ 1,302	\$ 85,987	\$ 15,145	\$ 3,456	\$ 18,601	\$ 104,588

See notes to consolidated financial statements.

Melwood Horticultural Training Center, Inc. and Affiliates

Consolidated Statement of Functional Expenses
Year Ended June 30, 2017
(In Thousands)

	Program Expenses				Total Program Expenses	Supporting Services			Total Expenses
	Employment Services	Community Services	Therapeutic Services	Veterans Services		Management and General	Fundraising	Total Supporting Services	
Wages and salaries	\$ 30,955	\$ 5,719	\$ 422	\$ 210	\$ 37,306	\$ 4,979	\$ 717	\$ 5,696	\$ 43,002
Employee benefits	10,730	1,018	58	31	11,837	1,006	132	1,138	12,975
Total salaries and related expenses	41,685	6,737	480	241	49,143	5,985	849	6,834	55,977
Professional and consulting fees	101	227	22	28	378	1,562	408	1,970	2,348
Supplies and materials	4,855	87	131	50	5,123	240	36	276	5,399
Buildings and occupancy	438	318	178	-	934	975	25	1,000	1,934
Equipment maintenance and rental	929	301	29	4	1,263	1,400	10	1,410	2,673
Support and contract services	15,287	108	4	4	15,403	135	1,477	1,612	17,015
Travel	49	250	158	19	476	134	32	166	642
Other	444	21	1	1	467	861	1	862	1,329
Interest and bank fees	13	3	1	-	17	188	2	190	207
Depreciation and amortization	779	379	211	-	1,369	440	8	448	1,817
Total expenses	\$ 64,580	\$ 8,431	\$ 1,215	\$ 347	\$ 74,573	\$ 11,920	\$ 2,848	\$ 14,768	\$ 89,341

See notes to consolidated financial statements.

Melwood Horticultural Training Center, Inc. and Affiliates

Consolidated Statements of Cash Flows
Years Ended June 30, 2018 and 2017
(In Thousands)

	2018	2017
Cash flows from operating activities:		
Change in net assets	\$ 11,615	\$ 780
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	1,746	1,817
Change in allowance for doubtful accounts	(13)	17
Unrealized and realized gain on investment, net	(147)	(205)
Gain on acquisition	(11,351)	-
Changes in assets and liabilities:		
Decrease (increase) in:		
Receivables	2,726	2,476
Inventory	18	(162)
Prepaid expenses	(433)	5
Other assets	210	(79)
Increase (decrease) in:		
Accounts payable and accrued expenses	(210)	896
Accrued payroll and withheld taxes	(405)	21
Deferred revenue	(87)	(147)
Other liabilities	37	49
Net cash provided by operating activities	3,706	5,468
Cash flows from investing activities:		
Cash portion of gain on acquisition	431	-
Purchase of property and equipment	(1,249)	(1,109)
Purchase of investments	(5,215)	(6,255)
Proceeds from sale of investments	4,967	3,172
Net cash used in investing activities	(1,066)	(4,192)
Cash flows from financing activities:		
Payments from line of credit	-	(733)
Principal payments on notes payable	(750)	(904)
Proceeds on notes payable	393	1,035
Net cash used in financing activities	(357)	(602)
Net increase in cash and cash equivalents	2,283	674
Cash and cash equivalents:		
Beginning	5,013	4,339
Ending	\$ 7,296	\$ 5,013
Supplemental disclosure of cash flow information:		
Interest paid	\$ 122	\$ 122

See notes to consolidated financial statements.

Melwood Horticultural Training Center, Inc. and Affiliates

Notes to Consolidated Financial Statements (In Thousands)

Note 1. Nature of Activities and Significant Accounting Policies

Nature of activities: Melwood Horticultural Training Center, Inc. and Affiliates (the Center) is comprised of four entities: Melwood Horticultural Training Center, Inc. (MHTC), Melwood-Dolly Housing, Inc. (MDH), Melwood Veterans Services, LLC (MVS) and Linden Resources, Inc. (Linden).

MHTC, a Maryland corporation, supports and empowers people with disabilities throughout the local Washington, D.C. national capital area, creating opportunities for their personal success. Programs include vocational training, employment, community living, leisure, travel and recreational services. MHTC serves over 2,100 people annually, is fully licensed by the Developmental Disabilities Administration of the State of Maryland, and is accredited by the Rehabilitation Accreditation Commission (CARF) and the American Camp Association (ACA). MHTC's programs are recognized locally, nationally and internationally.

Employment is provided through service contracts with major federal government agencies, with state, county, local governments and commercial firms. Financial stability is enhanced through fundraising initiatives that include a vehicle donation program. Support services are furnished in homes owned or leased by MHTC with staff provided to meet the needs of the residents. A unique recreation and travel program provides leisure opportunities either on-site at an MHTC-owned camping facility or through planned vacation trips.

MDH is a Maryland corporation, financially supported by U.S. Department of Housing and Urban Development (HUD) funds under Section 202 of the National Housing Act, or Section 811 of the National Affordable Housing Act. Sections 202 and 811 require compliance with regulations as required by HUD. MHTC has control over the Board of Directors of MDH.

MHTC established MVS, a Maryland Limited Liability Company, on May 5, 2016, for the purpose of assisting veterans with employment, career development, community reintegration and identifying additional resources and support services they need to thrive both in their professional and personal lives. Some of MVS' programming provides veterans suffering from physical and emotional trauma with strategies and techniques to approach life with renewed purpose and positivity. MHTC is the single member of MVS. As of June 30, 2018, there has yet to be any economic activity within the MVS entity.

Effective July 1, 2017, the Center became the sole member of Linden and has the ability to control the composition of Linden's Board of Directors. Linden is a 501(c)(3) nonprofit organization that was established in 1959 with a similar mission as the Center's exempt purpose. The transaction was accounted for as an acquisition for accounting purposes on July 1, 2017, where the Center, for consolidated financial reporting purposes, used fair value to initially record Linden's assets acquired and liabilities assumed. Linden's assets and liabilities at carrying value at June 30, 2017 were approximately \$6.1 million and \$1.6 million, respectively, for a net asset total of approximately \$4.5 million. Based on management's evaluation of Linden's assets and liabilities, the fair value of most of the assets and liabilities was approximately the book value with the exception of real property owned by Linden. Based on the appraisal information, the fair value of the real property exceeded the net carrying value of that real property. Under acquisition accounting principles for nonprofit organizations, the Center recorded a contribution on its consolidated statement of activities for the excess of assets over liabilities, at fair value, for the year ending June 30, 2018. Linden is the sole member of Linden Services LLC (LS LLC). LS LLC has no significant net assets or activities as of and for the year ended June 30, 2018.

A summary of significant accounting policies of the Center is as follows:

Basis of accounting: The accompanying consolidated financial statements are presented in accordance with the accrual basis of accounting, whereby unconditional support is recognized when received, revenue is recognized when earned and expenses are recognized when incurred.

Melwood Horticultural Training Center, Inc. and Affiliates

Notes to Consolidated Financial Statements (In Thousands)

Note 1. Nature of Activities and Significant Accounting Policies (Continued)

Basis of presentation: The consolidated financial statement presentation follows the recommendations under the Not-for-Profit Entities Topic of the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC). Under this ASC, the Center is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets and permanently restricted net assets.

Principles of consolidation: The consolidated financial statements include the accounts of MHTC, MDH, MVS and Linden. All significant intercompany accounts and transactions have been eliminated for consolidation.

Cash and cash equivalents: For purposes of the consolidated statements of cash flows, the Center considers all highly liquid investments available for current use with an initial maturity of three months or less when purchased to be cash equivalents. Cash and cash equivalents held in the investment portfolio are excluded from cash and cash equivalents in reporting cash flows.

Financial risk: The Center maintains its cash in bank deposit accounts, which at times, may exceed federally insured limits. The Center has not experienced any losses in such accounts. The Center believes it is not exposed to any significant financial risk on cash.

The Center invests in professionally managed portfolio that consists of various securities. Such investments are exposed to various risks, such as interest rate, market and credit. Due to the level of risk associated with such investments and the level of uncertainty related to changes in the value of such investments, it is at least reasonably possible that changes in risks in the near term could materially affect investment balances and the amounts reported in the consolidated financial statements.

Receivables: Receivables primarily consist of amounts due on business contracts from the federal government, and are carried at original invoice amount less an estimate made for doubtful receivables based on a review of all outstanding amounts on a monthly basis. Management determines the allowance for doubtful accounts by identifying troubled accounts and by using the historical experience applied to an aging of accounts. Receivables are written off when deemed uncollectible. Recoveries of receivables previously written off are recorded when received. The provision for doubtful accounts at June 30, 2018 and 2017, was \$325 and \$338, respectively.

Unbilled accounts receivables are included in receivables and consist of services performed prior to billing the federal government. Billings usually occur in the month after the services are performed or in accordance with specific contractual provisions.

Inventory: Inventory consists primarily of donated vehicles held for sale. Donated vehicles are stated at an estimated fair market value at the date of receipt.

Property and equipment: Property and equipment are carried at cost, less accumulated depreciation. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts and any resulting gain or loss is reflected in operations for the period. The cost of maintenance and repairs is charged to operations as incurred, and significant renewals and betterments are capitalized. MHTC capitalizes all asset purchases in excess of \$1.5; MDH capitalizes all asset purchases in excess of \$0.5; Linden capitalizes all asset purchases in excess of \$1.5.

Melwood Horticultural Training Center, Inc. and Affiliates

Notes to Consolidated Financial Statements (In Thousands)

Note 1. Nature of Activities and Significant Accounting Policies (Continued)

Depreciation of furniture, equipment, buildings and building improvements is provided on a straight-line basis over their estimated useful lives.

Donated property and equipment are recorded at their fair value at the date of receipt. The Center releases restrictions for contributions restricted to property and equipment as the property and equipment is placed into service. In the absence of donor-imposed restrictions on the use of the assets, gifts of long-lived assets are reported as unrestricted support.

Valuation of long-lived assets: The Center reviews property and equipment for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of the long-lived asset is measured by a comparison of the carrying amount of the asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value, less costs to sell.

Investments: Investments in equity securities with readily determinable fair values and all investments in debt securities are reflected at fair market value. To adjust the carrying values of these securities, the change in fair market value is recorded as a component of investment income (loss) in the consolidated statements of activities.

Support and revenue: Unconditional contributions received are recorded as unrestricted, temporarily restricted or permanently restricted support, depending on the existence and/or nature of any donor restrictions.

All 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 purpose restriction is accomplished), temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statements of activities as net assets released from restrictions. Temporarily restricted net assets are reported as unrestricted net assets if the restrictions are met in the same period received.

Unconditional promises to give, including grants, are recognized as revenue or gains in the period received and as assets, decreases of liabilities or expenses, depending on the form of the benefits received. Conditional promises to give, including grants, are recognized when the conditions on which they depend are substantially met.

Fixed-price contract revenue is recognized ratably over the contract term based on proportional performance or straight-line method, as appropriate. Time and materials contracts are recognized as time is incurred at the contractual rates and materials consumed in the performance of the contract. Contract revenue received in the current period for future periods is recorded as deferred revenue.

Service fees and sales revenue are recognized when services are provided or at the point of sale.

Donated materials consist of vehicles from private donors and are recognized at the auction sale price, which approximates fair value. Funds received from the sale of vehicles are used by the Center in various ongoing programs.

Melwood Horticultural Training Center, Inc. and Affiliates

Notes to Consolidated Financial Statements (In Thousands)

Note 1. Nature of Activities and Significant Accounting Policies (Continued)

Advertising: Advertising costs are expensed as incurred. For the years ended June 30, 2018 and 2017, the Center incurred advertising costs of \$1,223 and \$947, respectively.

Income taxes: MHTC, Linden, MDH and MVS are generally exempt from federal income taxes under the provisions of Section 501(c)(3) of the Internal Revenue Code (IRC). In addition, they qualify for charitable contribution deductions and have been classified as organizations that are not private foundations. Income that is not related to exempt purposes, less applicable deductions, is subject to federal and state corporate income taxes. MHTC, Linden, MDH and MVS did not have any material net unrelated business income for the years ended June 30, 2018 and 2017.

The Center adopted the accounting standard on accounting for uncertainty in income taxes, which 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 this guidance, the Center 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.

Management evaluated the Center's tax positions and concluded that the Center has taken no uncertain tax positions that require adjustment to the consolidated financial statements to comply with the provisions of this guidance. Generally, the Center is no longer subject to income tax examinations by the U.S. federal, state or local tax authorities for years before 2015.

Functional allocation of expenses: The costs of providing various programs and supporting services have been summarized on a functional basis in the consolidated statements of activities and functional expenses. Accordingly, certain supporting general and administrative costs have been allocated among the programs and supporting services benefited.

Use of estimates: The preparation of consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Subsequent events: The Center evaluated subsequent events through October 24, 2018, which is the date the consolidated financial statements were available to be issued.

Recent accounting pronouncements: In August, 2016, the FASB issued Accounting Standards Update (ASU) No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. The amendments in this ASU make improvements to the information provided in financial statements and accompanying notes of not-for-profit entities. The amendments set forth the FASB's improvements to net asset classification requirements and the information presented about a not-for-profit entity's liquidity, financial performance and cash flows. The ASU will be effective for fiscal years beginning after December 15, 2017. The changes in this ASU should generally be applied on a retrospective basis in the year that the ASU is first applied. Management has not evaluated the impact of this ASU on the consolidated financial statements.

Melwood Horticultural Training Center, Inc. and Affiliates

Notes to Consolidated Financial Statements (In Thousands)

Note 1. Nature of Activities and Significant Accounting Policies (Continued)

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*. The guidance in this ASU supersedes the leasing guidance in Topic 840, *Leases*. Under the new guidance, lessees are required to recognize lease assets and lease liabilities on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the statement of activities. The new standard is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. Management has not yet evaluated the impact of this ASU on the consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, to supersede nearly all existing revenue recognition guidance under generally accepted accounting principles in the United States of America (U.S. GAAP). The core principle of ASU No. 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity is expected to be entitled for those goods or services. ASU No. 2014-09 defines a five-step process to achieve this core principle and, in doing so, it is possible more judgment and estimates may be required within the revenue recognition process than required under existing U.S. GAAP, including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each performance obligation. ASU No. 2014-09, as deferred one year by ASU No. 2015-14, will be effective for annual reporting periods beginning after December 15, 2018, using either of two methods: (a) retrospective to each prior reporting period presented with the option to elect certain practical expedients as defined within ASU No. 2014-09; or (b) retrospective with the cumulative effect of initially applying ASU No. 2014-09 recognized at the date of initial application and providing certain additional disclosures as defined in ASU No. 2014-09. The Center has not yet selected a transition method and is currently evaluating the impact of the pending adoption of ASU No. 2014-09 on the consolidated financial statements.

In June 2018, the FASB issued ASU No. 2018-08, *Not-for-Profit Entities (Topic 958): Clarifying the Scope and Accounting Guidance for Contributions Received and Contributions Made*, which provides additional guidance on characterizing grants and similar contracts with resource providers as either exchange transactions or contributions, as well as distinguishing between conditional contributions and unconditional contributions. The updated standard will be effective for the Center as a resource recipient on July 1, 2019. Management has not yet evaluated the impact of this ASU on the consolidated financial statements.

Melwood Horticultural Training Center, Inc. and Affiliates

Notes to Consolidated Financial Statements (In Thousands)

Note 2. Property and Equipment

Property and equipment and accumulated depreciation at June 30, 2018, and depreciation expense for the year ended June 30, 2018, are as follows:

Asset Category	Estimated Useful Lives	Cost	Accumulated Depreciation	Net Book Value	Depreciation
Buildings and improvements	6 to 40 years	\$ 24,720	\$ 12,413	\$ 12,307	\$ 816
Transportation equipment	3 to 7 years	7,424	6,862	562	378
Training equipment and furnishings	3 to 10 years	4,519	3,805	714	298
Office equipment	3 to 7 years	5,989	4,890	1,099	248
Land	—	5,809	-	5,809	-
Work in progress - construction	—	324	-	324	-
Software in progress	—	34	-	34	-
Residential equipment	3 to 10 years	336	12	324	6
		<u>\$ 49,155</u>	<u>\$ 27,982</u>	<u>\$ 21,173</u>	<u>\$ 1,746</u>

Property and equipment and accumulated depreciation at June 30, 2017, and depreciation expense for the year ended June 30, 2017, are as follows:

Asset Category	Estimated Useful Lives	Cost	Accumulated Depreciation	Net Book Value	Depreciation
Buildings and improvements	6 to 40 years	\$ 20,677	\$ 11,633	\$ 9,044	\$ 697
Transportation equipment	3 to 7 years	7,179	6,800	379	538
Training equipment and furnishings	3 to 10 years	4,255	3,781	474	330
Office equipment	3 to 7 years	5,222	4,083	1,139	249
Land	—	1,509	-	1,509	-
Work in progress - construction	—	294	-	294	-
Software in progress	—	95	-	95	-
Residential equipment	3 to 10 years	306	15	291	3
		<u>\$ 39,537</u>	<u>\$ 26,312</u>	<u>\$ 13,225</u>	<u>\$ 1,817</u>

Note 3. Investments

Investments at June 30, 2018 and 2017, consist of the following:

	2018	2017
Equity securities, including exchange traded funds and mutual funds	\$ 5,031	\$ 4,117
Fixed income securities and mutual funds	2,264	1,765
Cash and cash equivalents	1,296	134
	<u>\$ 8,591</u>	<u>\$ 6,016</u>

Melwood Horticultural Training Center, Inc. and Affiliates

Notes to Consolidated Financial Statements (In Thousands)

Note 3. Investments (Continued)

Investment income gain for the years ended June 30, 2018 and 2017, is comprised as follows:

	2018	2017
Interest and dividend income	\$ 242	\$ 118
Realized and unrealized gains	147	205
Investment fees	(59)	(34)
	<u>\$ 330</u>	<u>\$ 289</u>

Note 4. Line of Credit

The Center maintains a \$15,000 revolving line of credit with a bank, which will expire in May 2021. Borrowings are collateralized by all of the Center's assets. Monthly interest payments are the lower of the bank's 30-day indexed prime rate (4.25% and 3.5% at June 30, 2018 and 2017) plus 0.5%, or 3.75%. The line of credit balance as of June 30, 2018 and 2017, was \$0.

Note 5. Notes Payable

Notes payable at June 30, 2018 and 2017, consist of the following:

	2018	2017
Term loan	\$ 1,054	\$ 1,238
Mortgage notes	594	600
Automobile loans	1,377	1,468
Capital leases	188	227
	<u>\$ 3,213</u>	<u>\$ 3,533</u>

Term loan: A bank term loan of \$2,085 was acquired during April 2009. The monthly payment for the loan is \$18 with an interest rate of 3.5%.

Mortgage notes: The Center has a real estate mortgage note with a principal balance of \$54 and \$60 at June 30, 2018 and 2017, respectively. The real estate associated with this note is used to provide facilities-based day programming. The note has an interest rate of 6% and calls for monthly payments of principal and interest of approximately \$1. In addition, MDH has a mortgage note with a principal balance of \$540 and \$540 at June 30, 2018 and 2017, respectively, representing a firm commitment for Capital Advance Financing provided by HUD and which requires no principal and interest payments unless an event of default occurs. If the organization does not default, the note will be forgiven on December 31, 2040.

Automobile loans: MHTC has automobile loans with interest rates of 4.25% and payment terms over 60 months. Monthly payments on these loans as of June 30, 2018 total \$45.

Capital leases: MHTC has capital leases for equipment with an interest rate of 1.3% and payments terms over 36 months. Monthly payments on these loans as of June 30, 2017 total \$9.

Melwood Horticultural Training Center, Inc. and Affiliates

Notes to Consolidated Financial Statements (In Thousands)

Note 5. Notes Payable (Continued)

The minimum principal payments on the mortgage, term loan, automobile loans and capital leases at June 30, 2018, are as follows:

Years ending June 30:		
2019	\$	854
2020		663
2021		430
2022		370
2023		245
Thereafter		651
	\$	<u>3,213</u>

Interest expense for the years ended June 30, 2018 and 2017, was \$122 and \$122, respectively.

Note 6. Fair Value Measurements

The Fair Value Measurement Topic of the FASB ASC establishes a fair value hierarchy that is based on the valuation inputs used in the fair value measurements. This topic applies to all assets and liabilities that are being measured and reported on a fair value basis. The topic requires that assets and liabilities carried at fair value be classified and disclosed in one of the following three categories:

Level 1: Quoted market prices in active markets for identical assets or liabilities.

Level 2: Observable market-based inputs or unobservable inputs corroborated by market data.

Level 3: Unobservable inputs that are not corroborated by market data.

Melwood Horticultural Training Center, Inc. and Affiliates

**Notes to Consolidated Financial Statements
(In Thousands)**

Note 6. Fair Value Measurements (Continued)

In determining the appropriate levels, the Center performs a detailed analysis of the assets and liabilities that are subject to the Fair Value Measurement Topic. At each reporting period, all assets and liabilities for which the fair value measurement is based on significant unobservable inputs are classified as Level 3. The tables below present the balances of assets measured at fair value on a recurring basis by level within the hierarchy:

	June 30, 2018			
	Total	Level 1	Level 2	Level 3
Fixed income:				
Government bonds	\$ 532	-	\$ 532	\$ -
Corporate bonds	1,732	-	1,732	-
Cash and cash equivalents:				
Institutional money market	1,296	1,296	-	-
Equity securities:				
Multialternative	771	771	-	-
Communication services	30	30	-	-
Real estate	114	114	-	-
Basic materials	296	296	-	-
World bond	432	432	-	-
Large growth	627	627	-	-
Large value	584	584	-	-
Consumer services	13	13	-	-
Financial	359	359	-	-
Technology	396	396	-	-
Consumer cyclical	423	423	-	-
Consumer defensive	262	262	-	-
Healthcare	184	184	-	-
Industrial goods	350	350	-	-
Utilities	62	62	-	-
Energy	128	128	-	-
	<u>\$ 8,591</u>	<u>\$ 6,327</u>	<u>\$ 2,264</u>	<u>\$ -</u>

Melwood Horticultural Training Center, Inc. and Affiliates

**Notes to Consolidated Financial Statements
(In Thousands)**

Note 6. Fair Value Measurements (Continued)

	June 30, 2017			
	Total	Level 1	Level 2	Level 3
Fixed income:				
Government bonds	\$ 137	-	\$ 137	\$ -
Corporate bonds	1,628	-	1,628	-
Cash and cash equivalents:				
Institutional money market	134	134	-	-
Equity securities:				
International	948	948	-	-
Large blend	-	-	-	-
Real estate	596	596	-	-
Basic materials	103	103	-	-
World bond	355	355	-	-
Large growth	386	386	-	-
Large value	699	699	-	-
Services	194	194	-	-
Financial	161	161	-	-
Technology	129	129	-	-
Consumer goods	277	277	-	-
Healthcare	50	50	-	-
Industrial goods	183	183	-	-
Utilities	23	23	-	-
Energy	13	13	-	-
	<u>\$ 6,016</u>	<u>\$ 4,251</u>	<u>\$ 1,765</u>	<u>\$ -</u>

The equity securities of the Center are publicly traded and are considered Level 1 items. The Center's government bonds and corporate bonds are priced based on their stated interest rates quality ratings. The interest and quality ratings are observable at commonly quoted intervals for the full term of the instruments and are, therefore, considered Level 2 items.

Melwood Horticultural Training Center, Inc. and Affiliates

Notes to Consolidated Financial Statements (In Thousands)

Note 7. Temporarily Restricted Net Assets

Temporarily restricted net assets include donor-restricted funds, which are only available for program activities or general support designated for future years. Temporarily restricted net assets are available for the following purposes:

	Balance June 30, 2017	Investment Gains	Released	Balance June 30, 2018
Donor-restricted endowment funds	\$ 408	\$ 65	\$ (67)	\$ 406
Bequest receivable	225	-	(225)	-
	<u>\$ 633</u>	<u>\$ 65</u>	<u>\$ (292)</u>	<u>\$ 406</u>

	Balance June 30, 2016	Investment Gains or Contributions	Released	Balance June 30, 2017
Donor-restricted endowment funds	\$ 279	\$ 129	\$ -	\$ 408
Bequest receivable	1,000	125	(900)	225
	<u>\$ 1,279</u>	<u>\$ 254</u>	<u>\$ (900)</u>	<u>\$ 633</u>

Note 8. Board Designated and Permanently Restricted Net Assets

The Board of Directors of MHTC has interpreted the Maryland-enacted version of the Uniform Prudent Management of Institutional Funds Act (UPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds, absent explicit donor stipulations to the contrary. The Board has determined that the original gift value for donor-restricted funds was \$942 (100% perpetual duration) as of June 30, 2018 and 2017. As a result of this interpretation, the Center 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 Center in a manner consistent with the standard of prudence prescribed by UPMIFA.

In accordance with UPMIFA, the Center considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

- The duration and preservation of the fund
- The purposes of the Center 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

Melwood Horticultural Training Center, Inc. and Affiliates

Notes to Consolidated Financial Statements (In Thousands)

Note 8. Board Designated and Permanently Restricted Net Assets (Continued)

- Other resources of the Center
- The investment policies of the Center

Return objectives and risk parameters: MHTC has adopted investment and spending policies for investment assets that attempt to provide a predictable stream of funding to programs supported by its investment, while seeking to maintain the purchasing power of the investment assets. Investment assets include those assets of donor-restricted funds that MHTC must hold in perpetuity or for a donor-specified period, as well as board designated funds. Under this policy, as approved by the Board of Directors, the investment assets are invested in a manner to seek average annual returns that are on par with similar groups of investments, depending on the stated investment objectives. A specific percentage rate of return, due to the state of the economy, has not been determined. This objective shall have a long-term, indefinite time horizon, and shall provide a wide diversification of investments to reduce risk and to produce incremental returns.

Strategies employed for achieving objectives: To satisfy its long-term, incremental rate of return objectives, MHTC relies on a total return strategy, in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). MHTC targets a diversified asset allocation base with the following parameters:

	Minimum	Current Exposure	Maximum
Equities	40%	59%	50%
Fixed income	40%	26%	50%
Cash	5%	15%	10%

Spending policy and how the investment objective relates to spending policy: Both donor-restricted and Board designated funds allow management to withdraw income from the endowment fund to be used for general operations. Effective for the year ended June 30, 2017, MHTC has adopted a 5% spending policy covering donor-restricted endowment funds. However, management, to date, has elected to roll over income to unrestricted funds for the Board designated fund type.

Investment net asset composition by type of fund as of June 30, 2018, is as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Board designated funds	\$ 7,243	\$ -	\$ -	\$ 7,243
Donor-restricted endowment funds	-	406	942	1,348
Total funds	\$ 7,243	\$ 406	\$ 942	\$ 8,591

Melwood Horticultural Training Center, Inc. and Affiliates

**Notes to Consolidated Financial Statements
(In Thousands)**

Note 8. Board Designated and Permanently Restricted Net Assets (Continued)

Investment net asset composition by type of fund as of June 30, 2017, is as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Board designated funds	\$ 4,666	\$ -	\$ -	\$ 4,666
Donor-restricted endowment funds	-	408	942	1,350
Total funds	<u>\$ 4,666</u>	<u>\$ 408</u>	<u>\$ 942</u>	<u>\$ 6,016</u>

Changes in investment net assets for the year ended June 30, 2018, are as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Investment net assets, beginning of year	\$ 4,666	\$ 408	\$ 942	\$ 6,016
Investment income, net	265	65	-	330
Contributions	2,312	-	-	2,312
Other changes:				
Appropriations	-	(67)	-	(67)
Designations	-	-	-	-
Investment net assets, end of year	<u>\$ 7,243</u>	<u>\$ 406</u>	<u>\$ 942</u>	<u>\$ 8,591</u>

Changes in investment net assets for the year ended June 30, 2017, are as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Investment net assets, beginning of year	\$ 1,507	\$ 279	\$ 942	\$ 2,728
Investment income, net	159	129	-	288
Contributions	3,000	-	-	3,000
Other changes:				
Appropriations	-	-	-	-
Designations	-	-	-	-
Investment net assets, end of year	<u>\$ 4,666</u>	<u>\$ 408</u>	<u>\$ 942</u>	<u>\$ 6,016</u>

Note 9. Board Designated Net Assets

Unrestricted board designated net assets at June 30, 2018 and 2017, consisted of \$7,243 and \$4,666, respectively, designated by the Center's Board of Directors to be used for the Melwood Investment Fund.

Melwood Horticultural Training Center, Inc. and Affiliates

Notes to Consolidated Financial Statements (In Thousands)

Note 10. Retirement and Other Compensation Plans

The Center has a contributory 403(b) Retirement Plan for all eligible non-Service Contract Act (SCA) employees. Employees are able to participate in the Plan immediately upon hire. The Plan provides a matching employer contribution under certain conditions. Employees are eligible to receive employer matching contributions after one year of service and 1,000 hours of work with the Center. All participating employees are eligible to receive matching contributions equal to half of their elected deferral up to 5% of wages. Employees who began employment with the Center on or after January 1, 2005, are subject to a five-year graded vesting schedule; all other employees are fully vested in the Center's contributions immediately upon receipt. For the years ended June 30, 2018 and 2017, the Center contributed \$168 and \$306, respectively, to the Plan.

The Center has a contributory 401(k) Retirement Plan for all SCA employees. Eligible employees are able to elect to have a portion of their pay deferred to this Plan. There is no employer match. Additionally, the Plan contains the Melwood Service Contract Act Retirement Plan (SCRCP).

The Center has the SCRCP falling under the SCA for its service contract employees working ten or more hours per month. Employees earn Health and Welfare funding on a per hour paid basis up to a maximum of 40 hours per week. Health and Welfare dollars pay for active employee benefits. Excess funds are then collected in a Premium Reserve Account until it had a balance equivalent to three months' premiums. After that, excess Health and Welfare funding is placed in the SCRCP on a quarterly basis.

The Center has a contingent executive severance obligation for the President and Chief Executive Officer in the case of an involuntary termination without cause. Upon such an event, a predetermined portion of one year's annual salary and any prorated earned bonus is required to be paid by the Center to the President/Chief Executive Officer. This payment may be made in one lump sum or over a reasonable period of time using standard pay practices at the Center's discretion.

The Center has established two deferred compensation plans under Section 457(b) and Section 457(f) of the IRC for the benefit of the President and Chief Executive Officer, respectively. Eligible contributions made the 457(b) plan vest immediately but contributions made to the 457(f) plan vest on June 30, 2020. Assets in the plans at June 30, 2018 and 2017 were \$120 and \$73, respectively, and included in other assets on the consolidated balance sheets. Accrued liabilities related to the plans at June 30, 2018, 2017 were \$87 and \$49, respectively, and included in other liabilities in the consolidated balance sheets.

Note 11. Customer Concentrations

During the years ended June 30, 2018 and 2017, approximately 85% and 86% of the Center's revenue was substantially derived from contracts with the federal government through the AbilityOne program. Significant reduction of funding under these contracts would have a significant impact on the operations of the Center.

Melwood Horticultural Training Center, Inc. and Affiliates

Notes to Consolidated Financial Statements (In Thousands)

Note 12. Contingencies

Grants: The Center receives support and revenue in the form of grants and contributions. The principal grantor is the State of Maryland, Department of Health and Mental Hygiene. Final determination of allowable costs is subject to audit or review by representatives or agents of the appropriate grantor. Management does not anticipate any adjustments by the grantors. The Center relies on the continued receipt of grants and contributions to provide ongoing programs.

Letters of credit: The Center has \$1,040 in letters of credit with a financial institution to cover potential workers' compensation claims. The letter with the financial institution is required by the Center's workers' compensation insurer and allows the insurer to draw on it at any time. In addition, another letter of credit for \$448 is in effect with the state of Maryland to cover unemployment costs, as the Center is self-insured. These letters of credit continue until final termination of the prior workers' compensation and until continued unemployment claims are finalized.

Claims and litigation: In the ordinary course of business, the Center is a party to claims and litigation. Management, based on consultation with legal counsel, is of the opinion that the ultimate outcome of these matters will have no material impact on the financial position, change in net assets or liquidity of the Center.

Self-insured agreement: MHTC maintains a self-insurance program for its unemployment insurance coverage for the states of Maryland, Virginia and the District of Columbia. Self-insurance cost is accrued based on claims reported as of the consolidated balance sheet date, as well as an estimated liability for claims incurred but not reported. The total accrued liability for self-insured unemployment costs was \$247 and \$220 as of June 30, 2018 and 2017, respectively.

Effective January 1, 2014, MHTC maintains a self-insured medical health plan model and a high-deductible workers' compensation plan, whereby MHTC covers the cost of medical claims its employees incurs. MHTC has stop loss coverage for this plan to cover claims in excess of \$175 per participant per year. Employees make contributions to the plan consistent with premiums paid per the old plan based on type of coverage. MHTC's liabilities for the self-insured medical health plan and workers' compensation plan are as follows:

	2018	2017
Self-insured medical health plan	\$ 1,097	\$ 1,123
Workers' compensation plan	247	220
	<u>\$ 1,344</u>	<u>\$ 1,343</u>

Melwood Horticultural Training Center, Inc. and Affiliates

Notes to Consolidated Financial Statements (In Thousands)

Note 13. Acquisition

On July 1, 2017, MHTC received a contribution of all the assets (net of liabilities assumed) of Linden to build on their presence in the AbilityOne contracting industry. There was no consideration paid for the net acquired assets. This resulted in a net contribution on acquisition of \$11,351.

The acquired net assets were adjusted to their fair values on the date of acquisition, which resulted in the following:

Cash	\$ 431
Accounts receivable	1,622
Prepaid expenses and other current assets	157
Investments	2,180
Property and equipment, net	8,445
Accounts payable and accrued expenses	(1,446)
Notes payable	(38)
Net assets acquired	<u>\$ 11,351</u>



RSM US LLP

Independent Auditor's Report on the Supplementary Information

To the Board of Directors
Melwood Horticultural Training Center, Inc.

We have audited the consolidated financial statements of Melwood Horticultural Training Center, Inc. and Affiliates (the Center) as of and for the years ended June 30, 2018 and 2017, and have issued our report thereon, which contained an unmodified opinion on those consolidated financial statements. See pages 1 and 2. Our audits were performed for the purpose of forming an opinion on the consolidated financial statements as a whole.

The consolidating information is presented for purposes of additional analysis rather than to present the financial position and results of activities of the individual entities and is 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 consolidating information has been subjected to the auditing procedures applied in the audit 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.

RSM US LLP

Gaithersburg, Maryland
October 24, 2018

Melwood Horticultural Training Center, Inc. and Affiliates

Consolidating Balance Sheet

June 30, 2018

(In Thousands)

	MHTC	Melwood Dolly Housing, Inc.	Linden	Consolidating Adjustment	Consolidated Total
Assets					
Current assets:					
Cash and cash equivalents	\$ 5,854	\$ 64	\$ 1,378	\$ -	\$ 7,296
Receivables, net	14,391	4	1,422	(485)	15,332
Inventory	281	-	-	-	281
Prepaid expenses	659	-	53	-	712
Total current assets	21,185	68	2,853	(485)	23,621
Property and equipment, net	12,516	322	8,335	-	21,173
Investments	8,591	-	-	-	8,591
Other assets	1,263	42	44	-	1,349
	\$ 43,555	\$ 432	\$ 11,232	\$ (485)	\$ 54,734
Liabilities and Net Assets					
Current liabilities:					
Accounts payable and accrued expenses	\$ 7,257	\$ 485	\$ 277	\$ (485)	\$ 7,534
Accrued payroll and withheld taxes	3,602	-	431	-	4,033
Notes payable, current portion	786	-	68	-	854
Deferred revenue	142	-	-	-	142
Total current liabilities	11,787	485	776	(485)	12,563
Notes payable, net of current portion	1,819	540	-	-	2,359
Other liabilities	86	1	-	-	87
	13,692	1,026	776	(485)	15,009
Net assets:					
Unrestricted:					
Operating	21,272	(594)	10,456	-	31,134
Board designated	7,243	-	-	-	7,243
	28,515	(594)	10,456	-	38,377
Temporarily restricted	406	-	-	-	406
Permanently restricted	942	-	-	-	942
	29,863	(594)	10,456	-	39,725
	\$ 43,555	\$ 432	\$ 11,232	\$ (485)	\$ 54,734

Melwood Horticultural Training Center, Inc. and Affiliates

**Consolidating Statement of Activities
Year Ended June 30, 2018
(In Thousands)**

	MHTC	Melwood Dolly Housing, Inc.	Linden	Consolidated Total
Support and revenue:				
Public support:				
Monetary contributions	\$ 364	\$ -	\$ 29	\$ 393
Donated items	2,799	-	-	2,799
Government and private grants	509	-	414	923
Contract revenue	77,802	-	10,781	88,583
Sales revenue	11	-	-	11
Service fees	8,897	-	2,577	11,474
Other	239	87	13	339
Total public support	90,621	87	13,814	104,522
Investment income	290	-	40	330
Total support and revenue	90,911	87	13,854	104,852
Expenses:				
Program expenses:				
Employment services	62,110	-	10,602	72,712
Community services	8,114	327	2,270	10,711
Recreational services	1,262	-	-	1,262
Veterans services	1,140	-	162	1,302
Total program expenses	72,626	327	13,034	85,987
Supporting services:				
Management and general	13,430	-	1,715	15,145
Fundraising	3,456	-	-	3,456
Total supporting services	16,886	-	1,715	18,601
Total expenses	89,512	327	14,749	104,588
Change in net assets before gain on acquisition	1,399	(240)	(895)	264
Gain on acquisition	-	-	11,351	11,351
Change in net assets	1,399	(240)	10,456	11,615
Net assets:				
Beginning	28,464	(354)	-	28,110
Ending	\$ 29,863	\$ (594)	\$ 10,456	\$ 39,725